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DRUGS GET SMART

How new medicines will more effectively target what ails you —and help prevent another Vioxx

BY KERRY CAPELL AND MICHAEL ARNDT (P. 76)

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The Audi A8.
Winner in the luxury segment.

The Audi A6.
Winner in the upper middle segme

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Germany's *auto motor und sport* magazine conducted a 2005 readers' poll in which more than 100,000 drivers voted for the best cars in each class. The ballots are in, and Audi finished first in four categories. Four rings. Four winners. Praise, indeed, from the world's toughest automotive critics. But you don't have to take their word for it. Stop by your local dealer to see the new, award-winning face of Audi. It's greater to lead than follow.

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The Audi A3.
Winner in the premium compact segment.

Audi

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DAVID J. O'REILLY
CHAIRMAN & CEO
CHEVRON CORPORATION

Chevron

Energy will be one of the defining issues of this century. One thing is clear: the era of easy oil is over. What we all do next will determine how well we meet the energy needs of the entire world in this century and beyond.

Demand is soaring like never before. As populations grow and economies take off, millions in the developing world are enjoying the benefits of a lifestyle that requires increasing amounts of energy. In fact, some say that in 20 years the world will consume 40% more oil than it does today. At the same time, many of the world's oil and gas fields are maturing. And new energy discoveries are mainly occurring in places where resources are difficult to extract, physically, economically and even politically. When growing demand meets tighter supplies, the result is more competition for the same resources.

We can wait until a crisis forces us to do something. Or we can commit to working together, and start by asking the tough questions: How do we meet the energy needs of the developing world and those of industrialized nations? What role will renewables and alternative energies play? What is the best way to protect our environment? How do we accelerate our conservation efforts? Whatever actions we take, we must look not just to next year, but to the next 50 years.

At Chevron, we believe that innovation, collaboration and conservation are the cornerstones on which to build this new world. We cannot do this alone. Corporations, governments and every citizen of this planet must be part of the solution as surely as they are part of the problem. We call upon scientists and educators, politicians and policy-makers, environmentalists, leaders of industry and each one of you to be part of reshaping the next era of energy.

Dave

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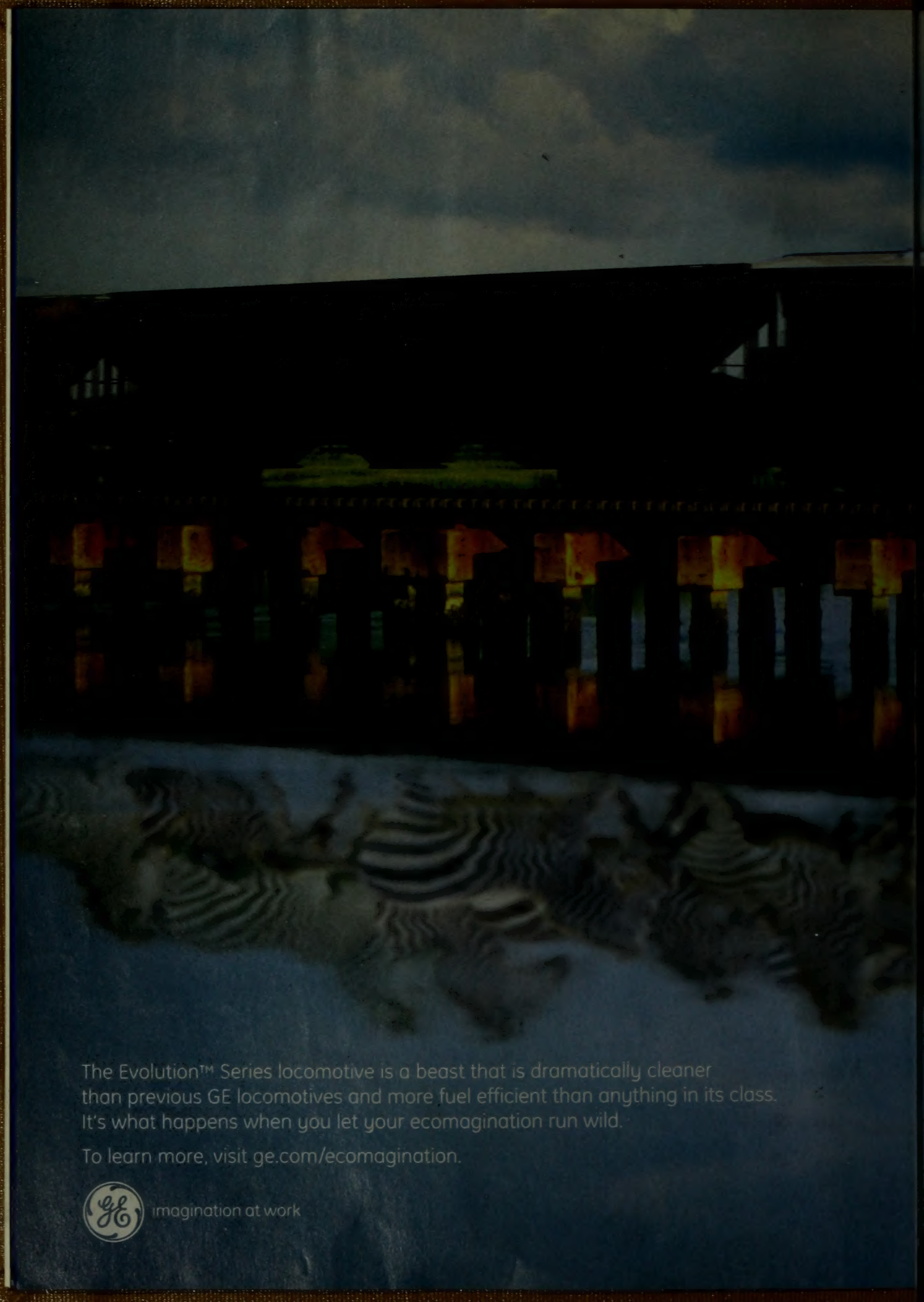
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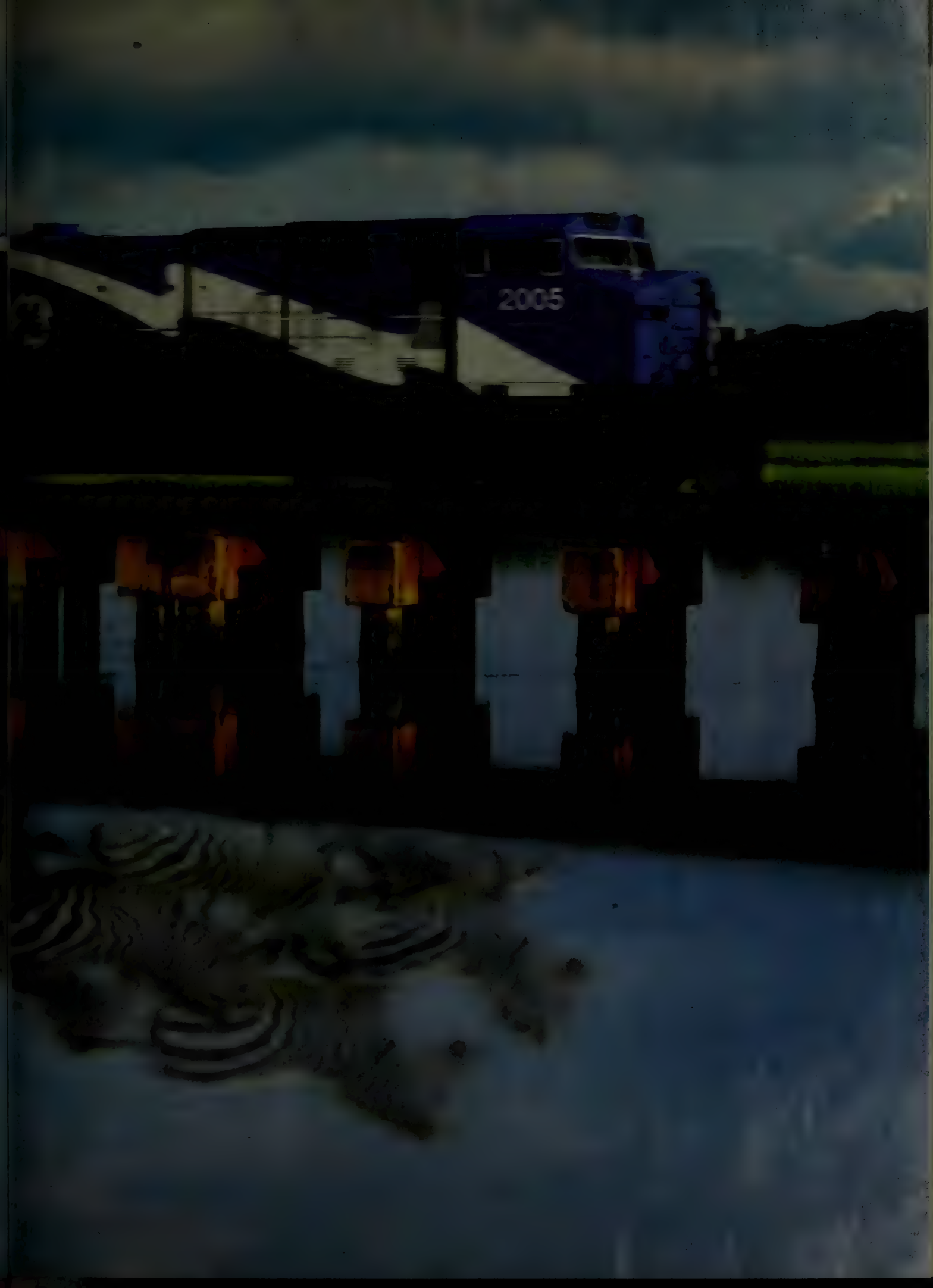
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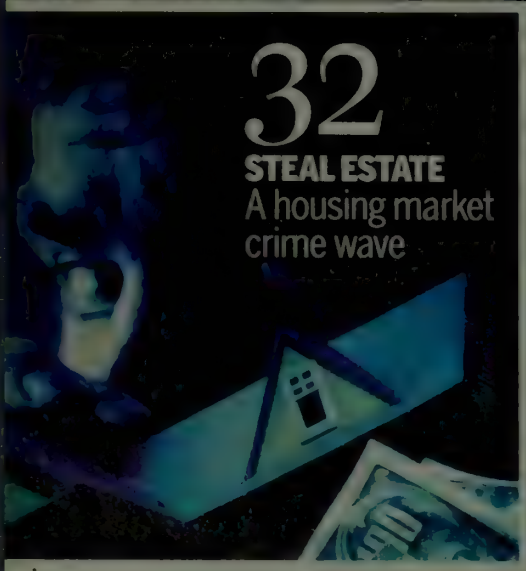
GETTING PERSONAL
The day of one-size-fits-all remedies may be ending. New tests will let doctors pick drugs based on each patient's DNA



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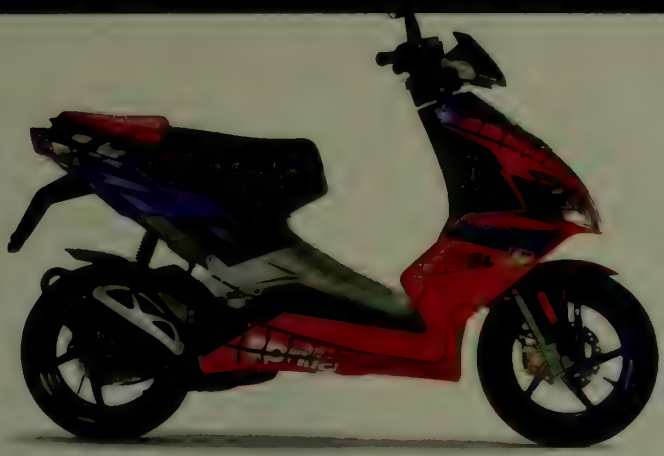

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"HENDRICK'S WON THE GIN CATEGORY"..
- THE WALL STREET JOURNAL

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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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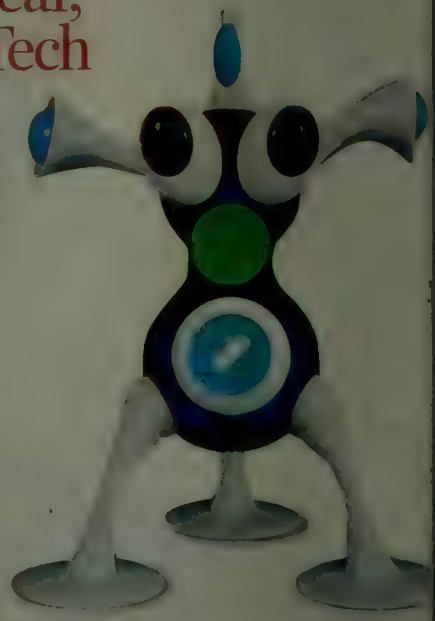
Special Report: This Year, Toys Are Going High Tech



Faced with lost sales to tech gadgets ranging from video games to MP3 players to cell phones, toymakers are fighting back by **joining the tech juggernaut**. They're cranking out toys that either work with these other gizmos or emulate them. This Special Report examines the trend and highlights several new toys that incorporate the gotta-have appeal of tech, such as **LeapFrog's new Fly** "pentop" computer and **Zizzle's iZ** music maker/player doll (right). Plus: A **slide show** of new high-tech toys

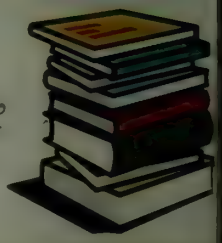
Let Us Know What Your Favorite Web Sites Are

Here's your chance to spread the word about the places you like most on the Web. Cast your vote in our Best of the Web Survey online now

Grading Back-to-School Stocks

Some outfits that gain from families' spending may make dicey buys. So we asked some equity pros to pinpoint investments with strong potential. Among their picks are Apple, Office Depot, and Gap

Executive Book Summaries



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UPFront

"This will be her opportunity to give her account of what happened."

–Penguin Group USA spokesman Will Weisser, on ousted HP CEO Carly Fiorina's deal to write a memoir, due out in fall 2006

EDITED BY DAN BEUCKE

PC PATROL

DELL FINDS ITSELF IN BLOG HELL

PC INDUSTRY circles have been buzzing for months about slipping customer support at **Dell**, a claim bolstered on Aug. 16 by a University of Michigan study that showed a hefty drop in customer satisfaction from a year ago. So the last thing Dell needed was for someone to turn the issue into a cause célèbre.

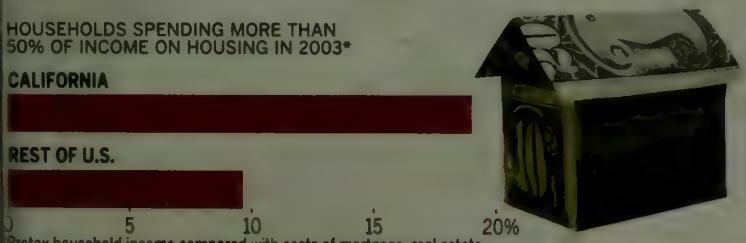
Enter Jeff Jarvis. Over the summer the media critic and popular blogger began writing on his personal blog, BuzzMachine, about his lengthy quest to fix a $1,600 computer, an ordeal that, according to him, included countless e-mails, some unanswered, and phone calls to Dell's service line. Jarvis wrote that he bought a service package that included in-home repairs, but when the PC overheated and malfunctioned, he was told to send it in. He did—and wrote that it still wasn't working upon return. Jarvis launched a series of attacks, including an Aug. 17 open letter to CEO Michael Dell: "The bottom line is that a low-price coupon may have gotten me to buy a Dell, but your product was a lemon, and your customer service was appalling." On Aug. 22, Jarvis finally got a refund. A day later he blogged that Dell's new policy of tracking down unhappy bloggers "is a start."

DELL A critic calls service "appalling"

Jarvis' rants struck a chord with other Dell customers. Daily visits to BuzzMachine have doubled, to over 10,000, estimates research firm Intelliseek. Among the responses: "Dude, get an Apple." Dell (page 90) is adding more call centers and improving training for phone reps, says consumer chief John Hamlin. As of Aug. 24, Dell had not replied to Jarvis' open letter but says it is "happy to talk with him as a customer." That might yield a happy ending—if he doesn't get put on hold. *–Louise Lee*

THE BIG PICTURE

HOUSE POOR Nearly one in five California home buyers spends at least half of income on housing



*Pretax household income compared with costs of mortgage, real estate taxes, insurance, utilities, fuel, mobile home costs, and condo fees

Data: Public Policy Institute of California analysis of U.S. Census Bureau data for homeowners of less than two years

SMOKE SIGNALS

That Cool Draw May Be Deadlier

MENTHOL EVOKES smooth refreshment, but for African American smokers, it may be lethal. Researchers have long puzzled over why black male smokers are 30% more likely to develop lung cancer and die from it than are white men, even though they smoke fewer cigarettes. New Harvard research points the finger at menthol cigarettes, which are favored by more than 70% of black smokers. Scientists at the **Harvard School of Public Health** analyzed the menthol in several brands and found much more had been added to those cigarettes labeled as light or ultralight. Because menthol is a numbing agent, they said, the high levels may lead to deeper inhalation.

That helps explain earlier studies showing smoking-cessation programs are least successful for black menthol smokers: They may draw in more addictive substances along with menthol. Gregory Connolly, a Harvard professor and lead study author, says that while "smokers may believe the term 'light' implies a reduction in disease risk, this is not true, and menthol may be playing an important role in this misperception." The study appears in the August issue of *Nicotine & Tobacco Research*. *–Catherine Arnst*

UP Front

PETROL PATROL

THIS BIG POOL IS JUST ABOUT FILLED UP

SABOTAGE in Iraq, an oil workers' strike in Ecuador, storms in the Gulf of Mexico—there's little good news in energy markets. That helps explain why oil hovers around $65 a barrel. But one source of price pressure could ease: The feds will soon finish filling the Strategic Petroleum Reserve.

TEXAS Filling the Strategic Reserve

The reserve, set up in '75 to guard against major oil supply disruptions, should hit its target of just over 700 million barrels in early September. The **Energy Dept.** has been filling the salt caverns under Texas and Louisiana since President George W. Bush ordered a big boost after 9/11. Recent purchases averaged 80,000 barrels a day—a trickle compared with U.S. daily consumption of 20 million barrels. But the purchases represent a good chunk of the world's 1.5 million barrels of spare capacity, says **Deutsche Bank** analyst Paul Sankey. The latest energy legislation mandates a boost in the reserve to 1 billion barrels, but no money has been allocated for it.

–Christopher Palmeri

MEDIA MANIA

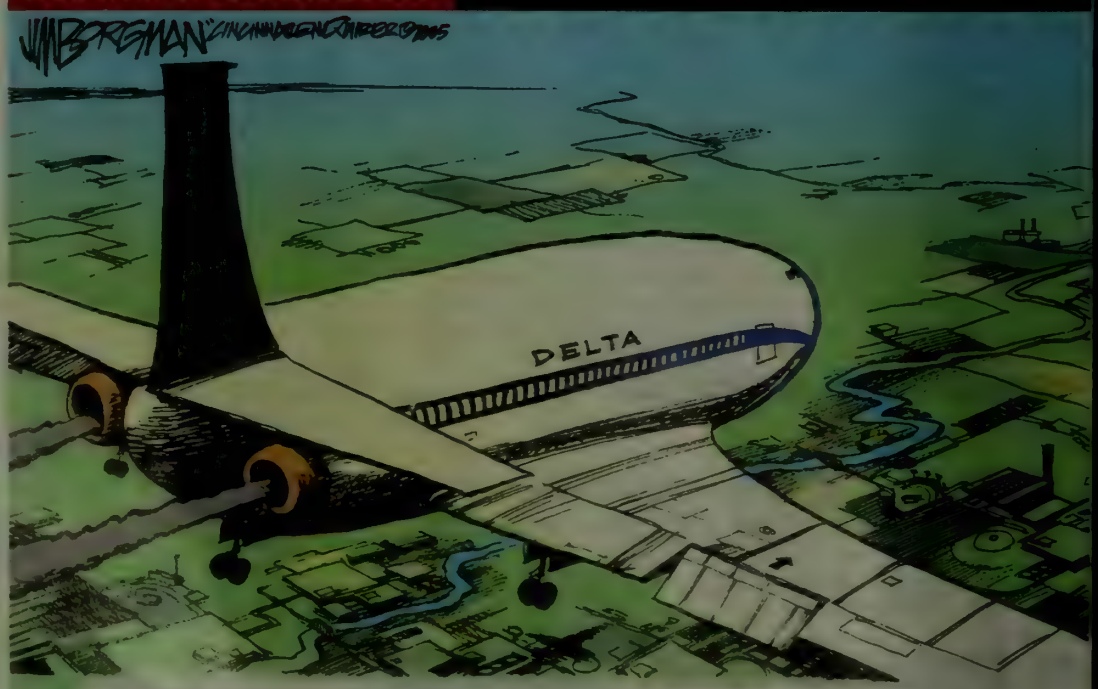
JAPAN Throughout August, 133 Japanese TV stations are airing commercials to promote the importance of...commercials. Japanese advertisers, like those in the U.S., worry about growing use of digital video recorders, now in 15% of Japan's homes. By letting users skip ads, DVRs have knocked $489 million off the value of commercials to advertisers, says the Nomura Research Institute. To win back viewers, the National Association of Commercial Broadcasters in Japan named Aug. 28 TV CM (commercial) Day. In one spot, singer Aya Matsuura works a puppet that says, "Commercials are fun, aren't they?" adding, "It's ventriloquism, so of course I'm made to say so." Viewers, of course, may skip these ads, too. –Hiroko Tashiro

LOVE LORE

CAN CUPID'S ARROW HIT A RUNNER?

A CHICAGO running-gear store has a new angle on speed dating. In an Aug. 17 promotion, 30 couples ran half-mile loops in a park before switching partners. After huffing through five moving mini-dates each, everyone adjourned to a bar for more spontaneous mixing. The runs themselves proved revealing. One guy told his partner he'd have to slow down to avoid leaving her in the dust. "Instant turn-off," says Cori Mack, 29, a physical therapist training for a marathon. The shop, **Momentum**, expects to stage a repeat in the spring. *–Joseph Weber*

DRAWN & QUARTERED



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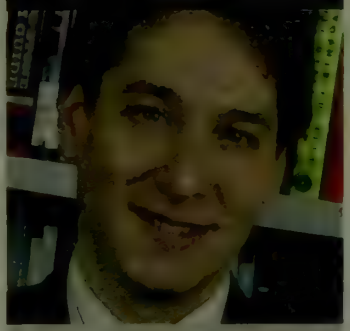
UP Front

FACE TIME

JONATHAN KARP



'MASSIVE' ATTENTION FOR AUTHORS

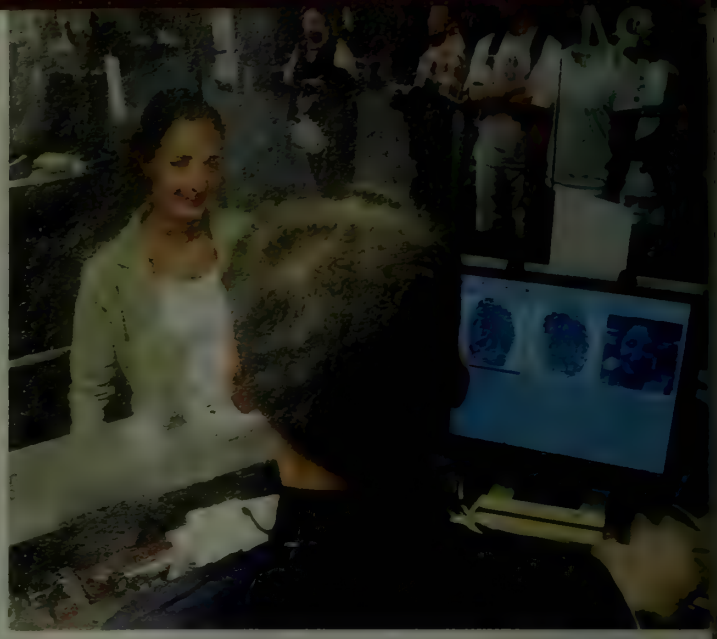
When Jonathan Karp resigned as editor-in-chief of Random House in June, there was speculation that he was leaving book publishing altogether. But Karp, 41, says he just wanted to follow a long-held belief that "talented authors deserve a massive amount of attention." As publisher and editor-in-chief of new imprint Warner Twelve at Warner Books, he can do just that. As the name suggests, Warner Twelve will release just 12 books a year (starting in spring, 2007), with Karp personally editing each. In an industry that issues 200,000 titles annually, he's hoping to produce one-of-a-kind works that cut through the noise. "To promising authors and their literary agents that we will publish nothing other than their books for a full month, we're saying ... we will do everything we can to make people pay attention to you."

During his 16 years at Random House, Karp edited a string of best-sellers, including *Seabiscuit* and *The Orchid Thief*. Now he just needs to find another dozen winners. *–Elizabeth Woyke*

POST 9/11

GETTING TOUGHER ON PASSPORTS

A WELTER of new U.S. passport rules are wreaking havoc with the travel plans of some Europeans. On June 25 a little-known rule kicked in requiring all travelers, including children, to carry their own machine-readable passports to enter the U.S. Previously, young children could in some cases travel on their parents' passports. The change—part of the Patriot Act—applies to 27 countries in the Visa Waiver Program, including Britain, France, and Germany. "We feel very, very disappointed, angry [and we're] sorry for the ones we were supposed to meet," says Marie-Hélène Hémon, a French citizen who was turned away at a Paris airport, from which she planned to fly with her two children to the U.S. for a two-week vacation. The Hémon family lost $3,700 worth of plane tickets through the mishap.



SNAPPED A photo on arrival

A case of post 9/11 overkill? The **State Dept.** says the requirement makes the U.S. safer and helps prevent child abductions. In the next two years, the U.S. will tighten rules in at least three different ways for countries in the Visa Waiver Program. Philippe Laloue, secretary general of a trade group representing 1,300 French travel agents, says the U.S. could do a better job of communicating changes. U.S. embassies sent out press releases and held round tables with airlines. "You don't want people pissed off because they can't get on a plane," says the State Dept.'s Angela Aggeler. But she concedes that the agency unfortunately can't reach everybody. *–Spencer Ante*

NET EFFECTS

I PAGLIACCI FOR THE iPOD SET

BEETHOVEN MAY soon find himself in the iPod Shuffle mix beside 50 Cent and the Black Eyed Peas. On Sept. 7 the largest independent U.S. distributor of classical music, **Naxos of America**, plans to sign a deal to allow the independent Online Distribution Alliance (ODA) to digitize Naxos' 7,000-track catalog of symphonies and operas, making hard-to-find files accessible to more Internet consumers.

Naxos already has deals to sell music through **iTunes, Napster,** and **Rhapsody.** However, the complexity and length of classical pieces means that fitting a lengthy Mahler symphony into one audio file is like "trying to fit a basketball through a garden hose," says Naxos President Jim Sturgeon. "There are just too many movements to download it the way you would a five-minute pop song."

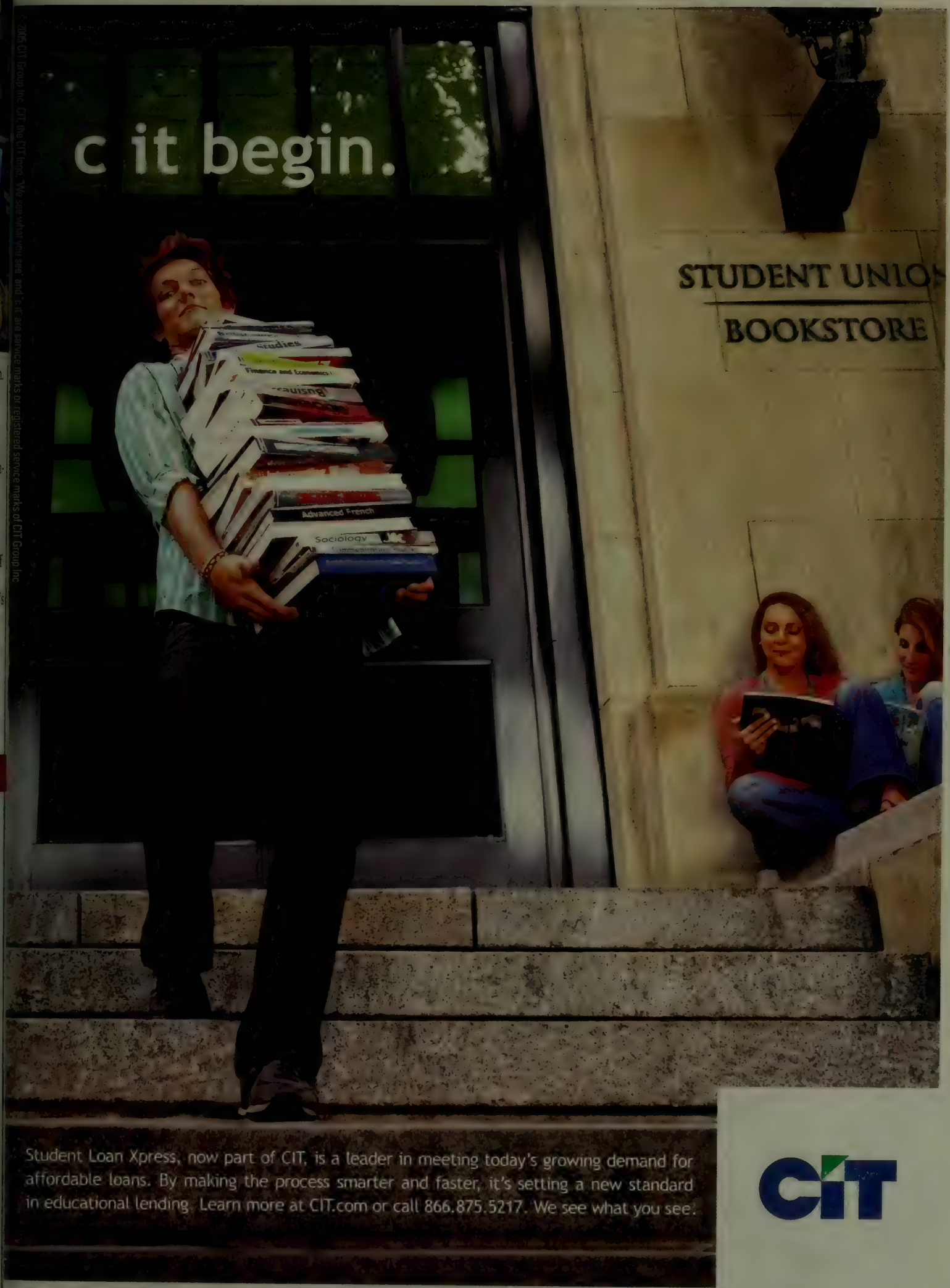
New software will digitize Naxos' tracks more efficiently so that pieces can be found by artist, title, and genre. That is how listeners search the music networks, where classical tunes now account for as little as 2% of the available downloads. *–Paula Lehman*

THE STAT

2

The percentage of U.S. households that visit blogs once a week or more. Only 6% report ever reading a blog. Other surveys show use is higher—up to 30%—for regular Internet users.

Data: Survey of 68,664 North American households conducted by Forrester Research



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"Even the most sophisticated monitoring systems are only as adept as those who are managing them."

–Ira A. Lipman
New York

THE STATE OF SURVEILLANCE: TOO MUCH DATA?

"THE STATE of surveillance" (Cover Story, Aug. 8) concentrated on sensors, but we also need help analyzing all the data that these sensors generate. A simple example: The U.S. has 25 million security cameras and only 295 million people, which means that most of this video is not being carefully watched. Too much video is watched only after the fact. Better analysis might help us catch at least a few perpetrators before they get away.

–Wayne Wolf
Princeton University
Princeton, N.J.

WITH THE MEDIA and many public figures decrying the profiling of potential terrorists by any method, it is unlikely that the authorities will be able to utilize the new and potentially useful techniques to thwart attacks against our citizenry. It is hoped that the general public will realize that we are vulnerable and the safety that is threatened is ours, allowing the authorities to use all available tools to combat terrorism.

–Nelson Marans
Silver Spring, Md.

AS A NATION, we are increasing our re liance on new technologies in the war o terror. Even the most sophisticated mon itoring systems are only as adept as thos who are managing them. Too often, it i the human side of security that is over looked. Already, billions have been sper and lost on technologies aimed at coun tering today's threats—only later found t be ineffective or unreliable.

Investments in sophisticated technolog must be augmented by the selection o people who can respond to security threat quickly and effectively. Society looks to th security industry for protection, and w have a responsibility to educate the publi about the necessity for constant vigilanc At the same time, the security industr faces an opportunity to grow and to elevat the reputation of the profession.

–Ira A. Lipma
Founder & Chairma
Guardsmar
New Yor

YOUR REPORT on the gadgetry for ou impending [James] Bondage shows tha we still don't really know what to make o the enormous data glut that results. W should recall East Germany, where th

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ReadersReport

CORRECTIONS & CLARIFICATIONS

In "China and India: What you need to know now" (Cover Story, Aug. 22/29), we misstated the number of listed companies in China. It is roughly 1,300, not 13,000.

In the table accompanying "Darker days at Daimler" (Cover story, Aug. 15) DaimlerChrysler's 2005 first-half operating profits for financial services were $863 million, not $589 million.

An "Et Cetera . . ." item (In Biz This Week, Aug. 15) should have read: "KKR, Five Mile Capital Partners, and Goldman Sachs bought a 60% stake in GMAC's commercial mortgage business" (not GMAC as a whole).

Stasi secret police became its largest industry and eventually overdosed on information, taking the country with it. All that's left: warehouses full of files. It is therefore more important for us that the FBI lacks hundreds of translators of Arabic and other languages and already can't cope with its backlog.

–John E. Ullmann
Hofstra University
Hempstead, N.Y.

RUNAWAY CEO PAY TAKES A TOLL ON CREATIVITY

THE JUXTAPOSITION of "Mr. McDonough, you have the floor" (Finance, Aug. 1) and "Get creative! (Special Report, Aug. 1) reveals the dilemma for many large organizations. The resentment of runaway executive compensation is sapping employees' creative energy, reducing stockholders' respect, and stimulating competition from foreign suppliers. As McDonough complains, outrageous executive compensation (even in companies doing poorly) is a major problem. Leaders such as Jeffrey R. Immelt at General Electric Co. would do well to put half their compensation into a fund that rewards employees who create valuable ideas that benefit their companies.

As one experienced in running a corporate idea program for many years, I can assure everyone that we haven't begun to achieve what the American workforce is capable of doing with desirable and fair leadership.

–Morley G. Melden
Monroe Township, N.J.

THESE B-SCHOOLS ARE ALSO STRONG ON DESIGN

GEORGE WASHINGTON University would have been a fair addition to "Tomorrow's B-school? It might be a D-school" ("Get creative!" Special Report, Aug. 1). The GW full-time MBA program offers a Management of Science, Technology & Innovation concentration (MSTI), as well as elective courses that integrate technology and creativity into our marketing, management, and entrepreneurship programs.

–Ryan Fairchild
Arlington, Va.

NORTHWESTERN UNIVERSITY was slighted in not being recognized for its "D" school, now in its fourth year. The program includes the basics of the Kellogg MBA program combined with professional engineering classes from the McCormick School of Engineering & Applied Science, that were developed specifically for this program.

–Walter Herbst
Northwestern University
Evanston, Ill.

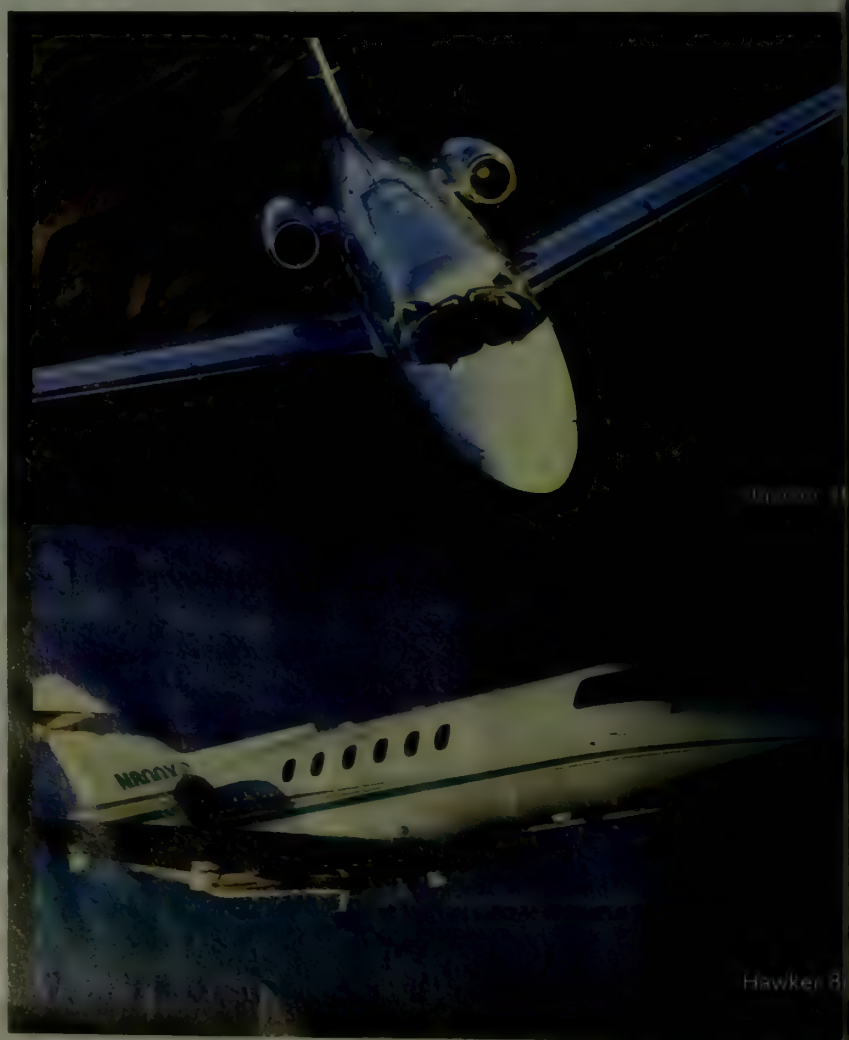
BIOTECH: PICKING THE RIGHT ROW TO HOE

"WHAT'S SO SCARY about rice?" (Science & Technology, Aug. 1) addressed well the benefits of using plants to grow biotec drugs. Plants yield a huge amount of bio mass compared with the ordinary veh cles of bacteria or mammalian cells an are much easier to purify than those veh cles. But the consequences of enviro mental complaints about cross-contam nation seem to be huge hindrances to th particularly advantageous process plant-based biotech.

Another way to accomplish the sam result is to grow the plants indoors, hy droponically, or in plastic-bag bio-rea tors. Although there is some addition cost, indoor biotech-modified plant grow ing protects both the biotech crop an other crops from cross-contamination, ob viating environmental complaints.

–Howard D. Sterlin
New Yor

IT'S A BIT DISINGENUOUS to character ize beer Goliath Anheuser-Busch Cos. a the injured party because of Ventria Bio science's desire to plant genetically mod ified rice in Missouri. Let's put things i perspective. Anheuser-Busch uses rice t make beer. Ventria uses rice to make th



Hawker 8

same health-promoting and life-saving proteins that every nursing infant receives from its mother. Ventria's rice will be used to prevent life-threatening infections in millions of infants, the elderly, and the sick around the world.

And what about those birds? Since no one has ever died (or even become ill) from eating genetically modified food, I'm really not very concerned about the possibility of a bird pooping a seed containing mother's milk proteins in my backyard.

–Raymond Rodriguez
University of California
Davis, Calif.

Editor's note: The writer is the founder and a former board member of Ventria.

MAKE ECONOMIC POLICY SERVE THE COMMON GOOD

THANK YOU, *BusinessWeek*, for placing Glenn Hubbard's "Happy 70th, Social Security" and Steven Rattner's "The rich get (much) richer" back to back (Viewpoint and Outside Shot, Aug. 8). As an Ivy League graduate with an income that places me above the 80% level, my personal experience is that a dynamic, growth-oriented economy requires a stronger government-backed safety net, not a throwback to an era of rugged individualism. My recent job transition entailed six months on unemployment insurance that barely covered my COBRA health insurance premiums and multiple rejections by private insurers to offer alternative coverage for me and my family.

I am all for a dynamic and growth-oriented economy, and I believe in open labor markets and Social Security reform. But personal experience tells me that economic security policy must be built around a concept of the greater common good, which is absent in both Hubbard's arguments as well as most coming from Washington these days.

–Bob Hitchner
Ventura, Calif.

SECURITY—AND TRADE—AT THE CANADIAN BORDER

ON BEHALF OF Canadian Manufacturers & Exporters, Canada's largest trade and industry association, I am concerned that "A border transformed" (International Business, Aug. 1) creates an impression that security at the U.S.-Mexico border is superior to that of the U.S.-Canada border. The U.S.-Canada border is more secure than ever. The management of the U.S.-Canada border is built on two centuries of collaboration and mutual trust, in contrast to the two centuries of frequently hostile feelings between the U.S. and Mexico that you cite in your article. Most if not all of the security and customs initiatives, technologies, and systems being undertaken at the U.S-Mexico border originated at the northern border in partnership with Canadian industry and government authorities.

Border security and efficiency are dual strategic priorities at the U.S.-Canada border. They must be, because the trade relationship between the U.S. and Canada is the largest in the world. U.S.-Canada trade amounted to $680 billion in 2004, with more than $1.8 billion worth of goods and services crossing the border every day. That's $1 million of business a minute.

–Jayson Myers
Senior Vice-President & Chief Economist
Canadian Manufacturers & Exporters
Ottawa

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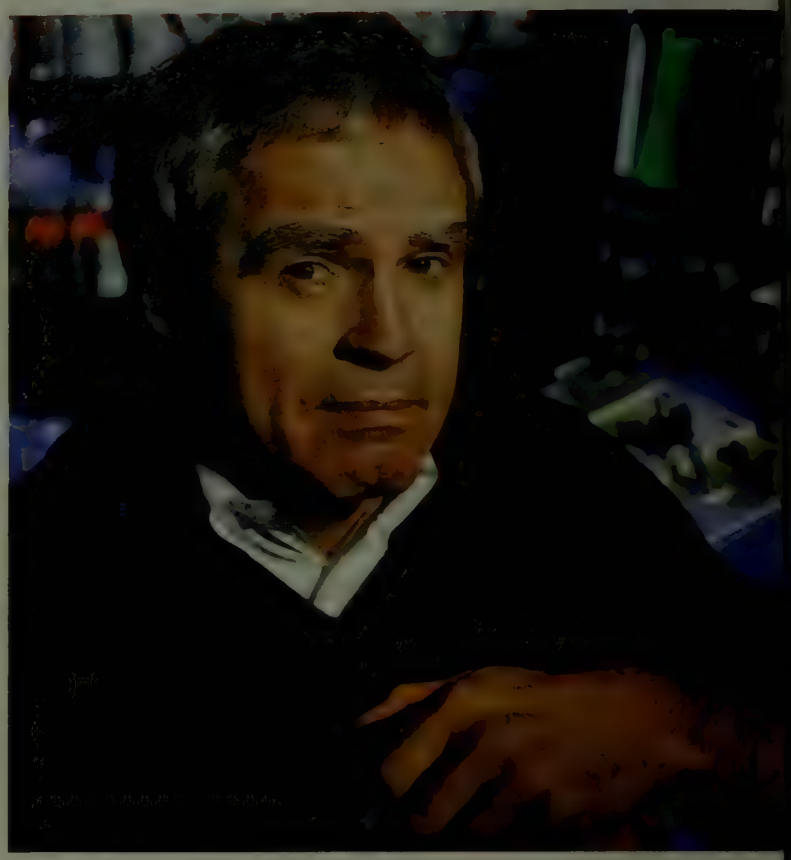
The Next Tiny Thing



HORST STÖRMER KICKS back in his spacious office in Columbia University's new Nanoscience and Engineering Center. Out the window are sweeping views of uptown Manhattan and the campus where the Nobel laureate in physics is learning a new craft: chemistry. ¶ "Biology never invented the copper wire," he proclaims. "Electric signal transmission in your body and brain is terribly slow—really just a bucket brigade [of cells] passing ions along," he says. In contrast, electricity flows through the copper wire on computer chips at close to the speed of light. Yet, he adds, biology pulls off one thing that trumps humanity's best technology: Starting with just two cells, it builds people with complex brains that sparkle with creativity. Biology's chemical factory, he marvels, regularly pulls off wonders of self-assembly.

Combine those same powers of self-assembly with modern materials, and it could mean the Next Big Thing in the world of computing. That's the goal driving much of his work at Columbia's Nanocenter.

Under the guidance of Störmer, who is one of three directors, scientists are working to harness molecules' natural ability to bond and assemble—and organize into high-performance, nano-size transistors and sophisticated circuits that will make today's computer chips seem like simpletons. Finding the key to nature's self-assembly bag of tricks also promises to help end the need for billion-dollar chipmaking plants and shrink electronic chips down to the molecular level. That promise is why Störmer, at age 56, is venturing into the world where physics meets chemistry.

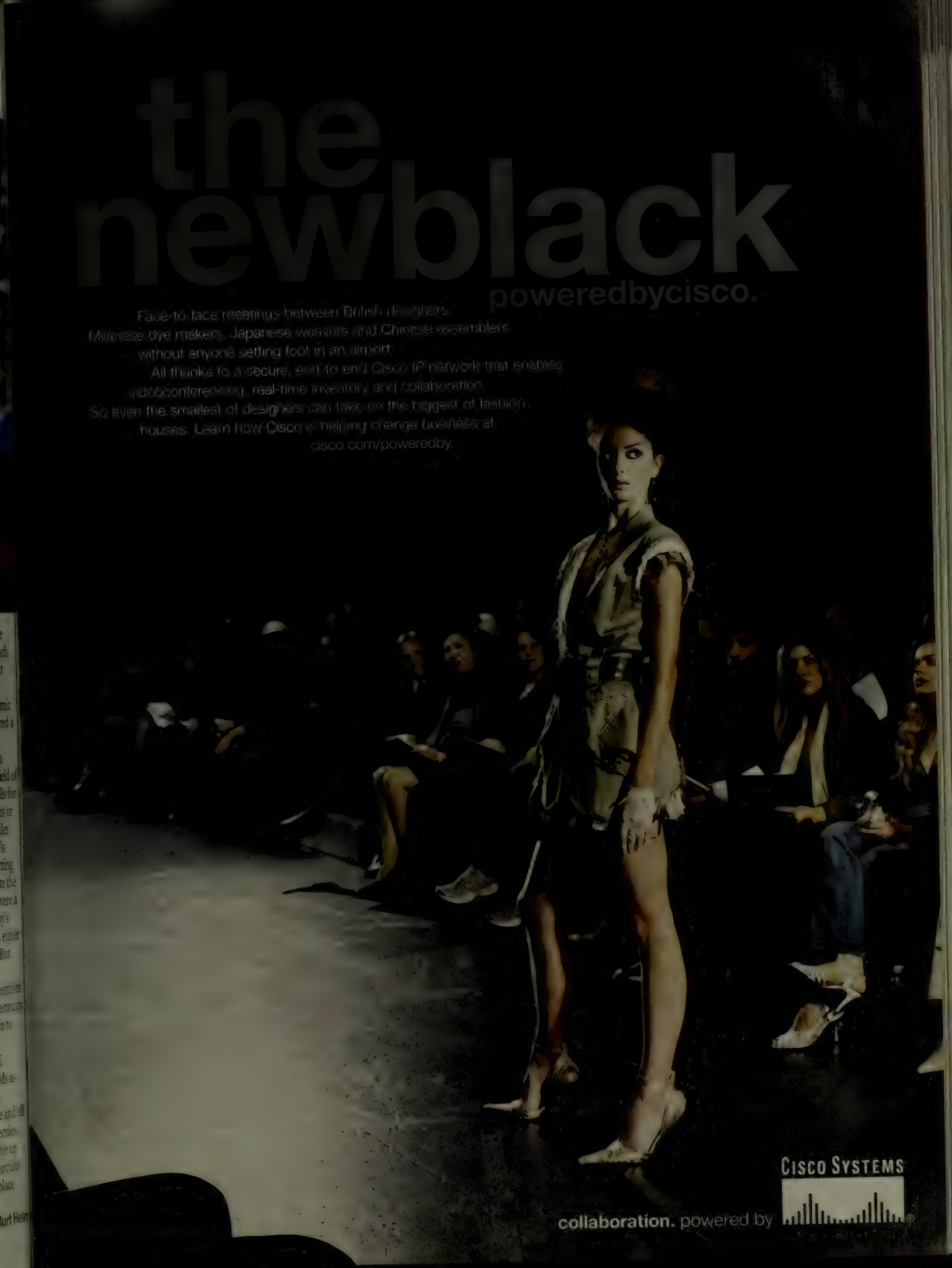
While a young scientist at Bell Laboratories in the late 1970s, Störmer pondered the mysteries of quantum mechanics—a realm of physics where subatomic particles defy classical rules and everyday logic. In 1981 he and fellow Bell Labs researcher Daniel Tsui were examining how electrons move through semiconductors under powerful magnetic fields and at extremely low temperatures. They made a bizarre discovery: Electrons can lose their discrete charge and behave as a sort of fluid. The observation, which was explained in theory a year later by Robert Laughlin at Lawrence Livermore National Laboratory, led to new understanding of the properties of subatomic particles. In 1998, the three scientists shared a Nobel prize in physics.

Nobel laureate Störmer's goal: Transistors that bond and assemble like molecules

These days, Störmer is hoping to make a similar leap of discovery in the emerging field of nanoelectronics. If Moore's Law, which calls for computer power to double every 18 months or so, is to hold, just making transistors smaller will no longer be sufficient. For tomorrow's nano-size devices, the challenge is connecting them into functioning circuits. To illustrate the problem, Störmer holds up a pencil. If it were a molecular-sized transistor, attaching today's skinniest wires, he says, would be like tacking a truck on either end. So it's vital for connecting wires to self-assemble. But mimicking biology's secrets enters a "no-man's land" between chemistry and physics. In Störmer's group, chemists and physicists work side by side to understand how electricity travels through organic molecules, and then tease them to assemble into complex structures.

The center's work is in its early days. The team is still exploring various molecules to determine which are duds as semiconductors and which could be high-performance wonders, and why. "You've got the whole periodic table and all its possible combinations" for building candidate molecules, says Störmer. "At some point, somebody's going to come up with the molecule" that will replace silicon. Then the circuits for future computers and electronic gear will fall into place naturally, assembling themselves. ■

–By Burt Helm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BY CLIFF EDWARDS

A Poltergeist in My Plasma TV

My $5,000 LG plasma TV is haunted. And I'm not talking about "ghost" images you see on the screen even after the set is turned off. O.K., it hasn't yet started whispering "Get out," but it's malevolent nonetheless. In the two months that I've been testing it, the unit has confounded my every attempt to get it to work normally.

I had high hopes for LG's ambitious 50-inch plasma HDTV. The first big-brand television with a TiVo-like digital video recorder built-in , it relies on a 160-gigabyte hard drive and Gemstar-TV Guide software to record up to 14 hours of high-definition or 62 hours of standard resolution programming. With a mirror-like black finish and beveled edges, the set is a real head turner. A thoughtfully designed remote control—also in shiny black—completes the promise of good things to come.

THE LG 50PY2DR

For the first few weeks the LG set delivered. First, I plugged my Comcast cable into the TV as well as an antenna to pluck local digital TV signals from out of the air. Setup is simple and intuitive, taking about five minutes, though you have to wait overnight for eight days of *TV Guide* data to download. After that, at the touch of a button, the hard drive will store programming. I recorded episodes of *The Simpsons*, *The Amazing Race*, and *Family Guy*. The picture, of course, is as good as the signal—in this case delivering excellent color saturation and contrast with little need for fine adjustment.

THE HAUNTING BEGAN nearly a month into my tests. At 1 a.m., the set suddenly and loudly fired up—a disconcerting thing since it was set up in my bedroom. Worse, it refused to turn off, responding neither to the remote nor the off switch on the TV. With no choice, I unplugged the set, then plugged it back in. Nearly an hour later, though, the set burst into life again. For three nights running, I struggled with the same scenario—and lost each time. More frustrating yet, the *TV Guide* data stopped downloading, rendering the core digital video recording feature useless.

Acknowledging defeat, I called the tech gurus at LG. After a bit of hemming and hawing, they sent a flash memory card loaded with software aimed at fixing the problem. Apparently, early production models of the set suffered a software "memory leak." That means tiny errors in the programming replicated in ways that made the TV act unpredictably. Using the picture-card viewer slot built into the set, I installed the software patch and hoped for the best.

It was not to be. The *TV Guide* data—which by then had not updated for a couple of weeks—yet again failed to download overnight. And after a lull of a week, the set began turning itself on again. An LG executive pointed out that most buyers of this set would simply install a CableCARD and use the built-in recorder, rather than plug in a DirecTV-TiVo and DISH personal video recorder, as I had done. But given that the set has connections for additional equipment, that should not have been a problem.

LG's $5,000 set worked for a month. Then things got weird

As a last-ditch effort to get the set working, I moved it out of the bedroom. Then I had a Comcast technician install a CableCARD to decode premium programming without the box. Voila! The *TV Guide* downloaded, and I could again use the digital video recording function. But like a bad dream, disaster struck once more. Both high-definition multimedia interfaces (HDMI) that I had used to connect DirecTV and DISH Network satellite boxes failed. When I plugged those same boxes into the component connectors, everything looked lime green, and no amount of picture adjustment changed that.

Finally, LG decided to replace the set. LG may either replace or repair a set under warranty, on a case by case basis. Five days into a review of the new set, everything works as promised—complete with all the other devices I had connected previously. No ghosts in the middle of the night. No green slime. Still, I'm not giving up my TiVo just yet. ■

BusinessWeek online Steve Wildstrom is on vacation. For a collection of past columns and online-only reviews of technology products, go to Technology & You at www.businessweek.com/go/techmaven/

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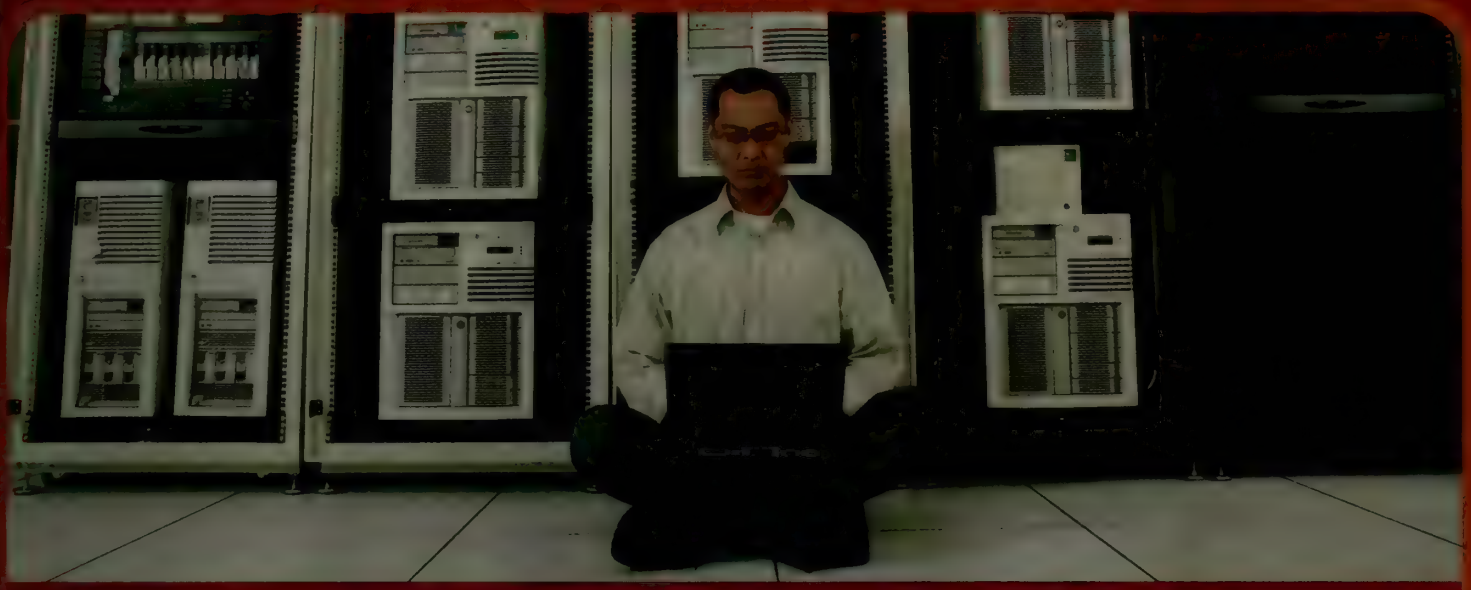

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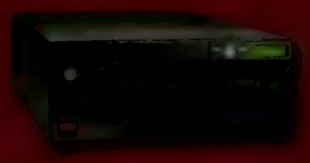

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MediaCentric

BY JON FINE

Media, Marketing, and Advertising in the 21st Century

An Ugly Battle for the Clicker

If all goes according to plan, the next few years will bring an extraordinarily expensive battle for consumers' living rooms, as telephone companies spend billions to update their networks and leap into next-generation TV. ¶ Just underscore that phrase "if all goes according to plan." ¶ We are talking about rewiring the world, or at least a good chunk

of the U.S., and the telcos are girding for a very long war. The time frame may be a decade. The spending of just one major player—Verizon Communications—is expected to exceed $15 billion.

Telephone companies have long tried to layer content businesses atop their networks, which go into virtually every home, with a notable lack of success. In the early '90s telcos made noises about running what were quaintly called "information services" over phone lines. Newspaper executives feared—seriously—that telcos would kneecap their plans to provide 900-number-style services, like, say, horoscopes. But telcos' efforts amounted to little, and one media trade magazine delicately noted that "readers used to getting their information for 50¢ or less are not easily persuaded to pay more than $2 a minute for it on a telephone line." In the mid-'90s Pacific Telesis and BellSouth signed up content partners for first-generation interactive services—which sometimes meant operator-assisted database services. But despite some lovely names—R.I.P., Bell Atlantic brainchild Stargazer—none launched.

THAT WAS A SIMPLER, more innocent time, when forward thinkers routinely talked up the imminent potential of video-on-demand—while living in a 9600-baud, dial-up world. But even in a broadband world, telcos face ludicrously difficult terrain. They're entering a field full of established players—and, via satellite providers like DirecTV, established challengers—in a zero-sum market in which growth equals pilfering rivals' customers. Cable outfits such as Time Warner now offer cable telephony, speeding erosion of telcos' cornerstone business. Then there's the $15 billion-plus Verizon has earmarked to rebuild its network all the way down to individual households, with fiber-optic lines to allow two-way interactivity. (If, like Verizon, your annual cash flow tops $25 billion, that cost becomes less terrifying.)

Telcos need to lasso major programming sources—which they've begun doing—from HBO to broadcast networks, especially since they're counting heavily on video-on-demand. Barring government or legal intervention, they must also win franchise rights in every municipality they wish to serve. (There are thousands in the U.S.) Established cable players are upgrading their networks as well. And telcos must wrap their collective brain around selling an entirely new service. All of this has to happen, more or less, right now. Verizon expects its redone network to be available to 3 million homes—around 10% of its current customer base—by yearend. But Deutsche Bank Securities analyst Viktor Shvets figures Verizon won't win 2 million subscribers to a TV/broadband/telephony package until 2008, and even then, the packages will be available to fewer than half of Verizon's present-day customers.

Telcos are challenging cable to deliver TV, but if history is any guide...

Sound daunting yet?

Maybe not. One veteran cable executive says it's a mistake to assume customers can't be poached. Verizon plans to underprice cable, and next-generation technologies may open next-generation revenue streams. Souped-up TV platforms could give "tremendous advantages to the telcos," says Adam Gerber, senior vice-president of Starcom MediaVest, and can "create easily measurable and trackable platforms for advertising"—one attribute of Web advertising present-day TV cannot match.

But telcos' prospects would be more compelling if their earlier bids for next-generation media services hadn't failed so miserably. They're also uniquely ill-suited to attack cable's Achilles heel: lousy service. As a pal likes to point out, no one pulls you aside at a cocktail party to say how much they love their cable or phone company. The battle for the living room may boil down to telco vs. cable, but don't expect either to win consumers' hearts. This fight is to see who is least despised. ■

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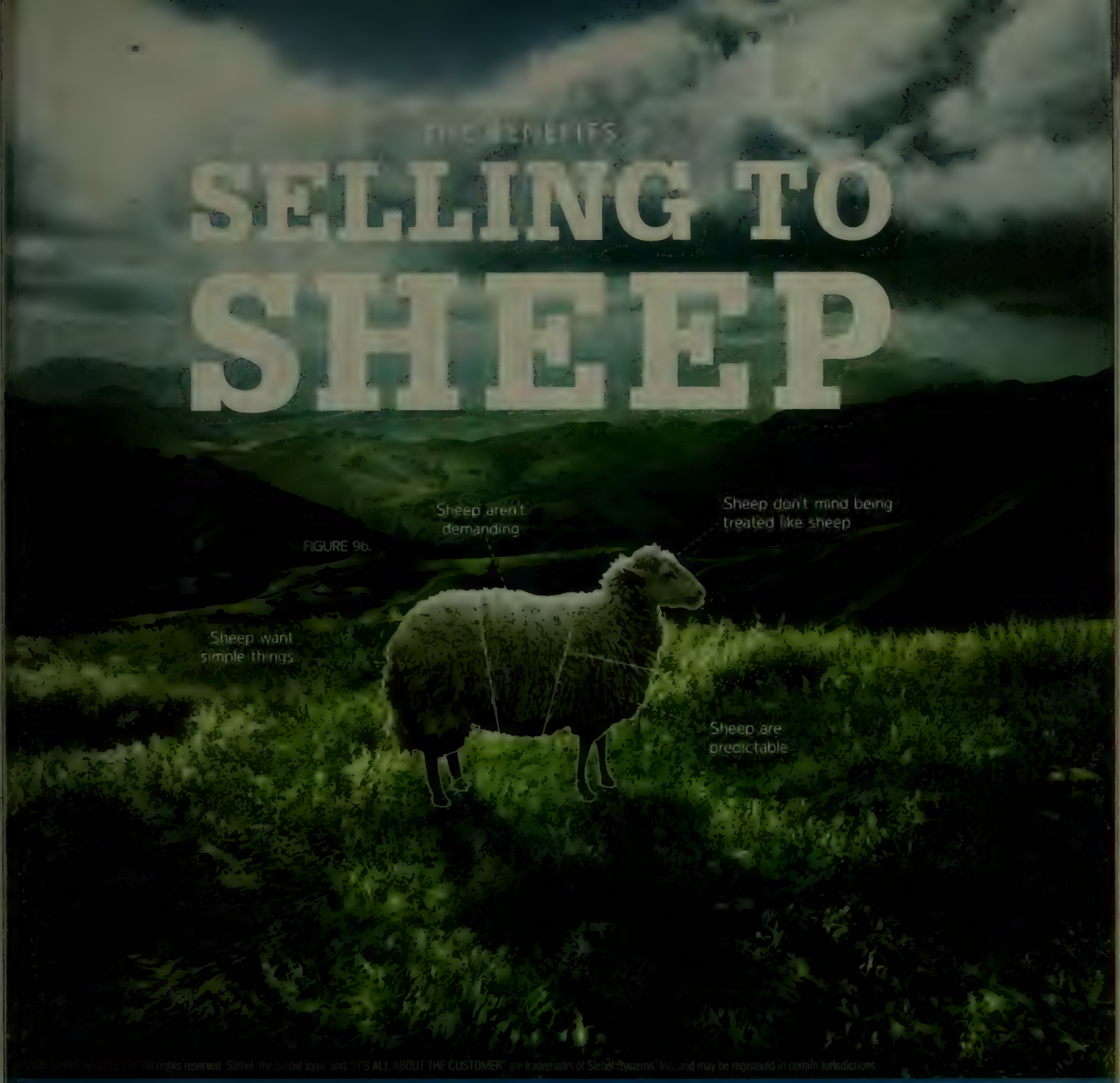

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The Barker Portfolio

BY ROBERT BARKER

A Robot That Could Hit a Wall

Scooba may mean nothing to you today, but by the holidays, chances are you'll crave one. Scooba is a sibling to Roomba, the robotic vacuum cleaner beloved by reviewers—*BusinessWeek* recently gave it a design award—and consumers, who in three years have bought 1.2 million units. Scooba, set to go on sale this fall, doesn't just pick up dirt. It also washes, scrubs, and dries tile, wood, or linoleum floors, all in one pass. Price: about $399.

Roomba, Scooba, military vehicles called PackBots, and more; all are creations of iRobot, a Burlington (Mass.) outfit that in 1990 sprang from Massachusetts Institute of Technology. Scooba isn't all that iRobot is getting ready to sell. It's also preparing an initial public offering of stock to be led by Morgan Stanley and JPMorgan Chase. Key terms of the deal—price, amount of equity offered—have yet to be estimated, and iRobot execs are keeping quiet. So it's too early to judge whether the IPO is worth a bid. Just the same, iRobot's registration statement includes plenty of data for investors to suck up and crunch.

THERE'S LOTS TO LIKE about iRobot, starting with 19 U.S. patents and 25 more pending. Then there is its record of bringing to consumers the sort of robotics Chief Executive Officer Colin Angle helped install on the 1997 Mars rover Sojourner. It's also heartening that iRobot is diversified via its military-industrial robots. Sales of this line, including some of the $50,000 to $115,000 PackBots used in Iraq for bomb disposal and reconnaissance, added nearly a quarter of last year's total revenue. Investors will like iRobot's relatively modest executive salaries (for Angle, $234,520 in 2004), and its adherence to the increasingly rare one-share, one-vote rule on corporate matters. (Dolby Laboratories, DreamWorks Animation, and Google are all recent issues that don't.) Best of all, iRobot meets the top criteria on its mission statement: No. 1, Build Cool Stuff; No. 2, Deliver Great Product.

SCOOBA It scrubs your floors. But what about red ink?

iRobot: Ready to Clean Up?

Revenue	$110
Operating Income	-4
Cash	15
Total Debt and Preferred Stock	38
Shareholder's Equity	-31
Tentative Symbol	IRBT

Scooba Video
irobot.com/consumer/scooba_sneak_preview.cfm

[illegible] income statements data for 12 months ended July 2 2005, balance sheet [illegible] date

Data: Company reports

That said, one can't help but notice that iRobot is faltering at item No. 3: Make Money (table). Although the company last year did net its first annual profit, $219,000 on $95 million in revenue, it lost $18.2 million over the two previous years. This year's first-half showing is not encouraging. Despite much higher revenues ($43 million vs. $28.6 million in the comparable 2004 period), iRobot's loss widened to $7.2 million from $3 million. The company has kept going by selling $38 million in preferred stock to venture capitalists.

As always, there are worries, such as iRobot's reliance on a single Chinese contract manufacturer for its consumer products and a sole Ohio maker for its military robots. In addition, while iRobot sells Roomba on the Web at its own site and at such others as Amazon.com, it says it enjoys distribution at some 7,000 retail outlets, including weighty chains such as Best Buy, Home Depot, and Target. This might be overstating iRobot's reach, however. One afternoon, I went looking for Roomba near my Florida home. None at Best Buy, none at Home Depot, none at Target. Clerks at Best Buy and Home Depot said Roomba hadn't been stocked since the holidays. I did find 13 Roombas at Bed Bath & Beyond, but they were partly hidden by displays for George Foreman Grills and the Hoover FloorMate SpinScrub 500 hard floor cleaner. I later located two more Roombas at Sears.

If the Scooba does everything iRobot claims, shoppers will find it, online or off. With stock in iRobot likely to be offered near Scooba's debut, underwriters' inventories are a good bet to sell out fast. What might the shares be worth? Rivals' multiples won't be much help. According to Standard & Poor's Capital IQ unit, the Hoover brand's parent, Maytag, has an equity value of nearly 0.4 times sales, while Sweden's Electrolux goes for about the same multiple. Such iRobot rivals for government sales, General Dynamics and Lockheed Martin, go for price-sales ratios of 1.2 and 0.8, respectively. Count on iRobot, with revenues of $110 million in the past four quarters, to start trading on NASDAQ at a much higher valuation—and risk. ■

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BY JAMES C. COOPER & KATHLEEN MADIGAN

This Oil Spike Is Harder to Handle

Slower spending or faster inflation look distinctly possible as costs mount

U.S. ECONOMY

Back in the spring of 2004 the key question for the outlook was: Will $40-per-barrel oil cripple the economy? Later that year it became: What about $50 oil? Now with oil stubbornly at around $65 per barrel, the question of oil's effect on growth is taking on a new urgency. After all, rosy economic forecasts at the end of 2004 were generally founded on oil prices settling down to $39 by the end of 2005, based on a December Business Outlook survey of economists. Even just this June, a follow-up survey pegged oil at $48 by yearend.

What's increasingly evident is that costlier energy may be a permanent part of the economic landscape. If oil holds at $65 for the rest of the year, the 2005 price will average about $59. The rise of China and India—and their oil needs—is a big reason (page 52). In the past four years, China's share of world oil demand has risen from 6.3% to 8%, or by some 2 million barrels of oil per day. That rate is equivalent to Iraq's entire production.

The speed with which oil prices have spiked adds to the concern (chart). The inflation-adjusted price of oil has doubled in less than two years. The last time that happened was in 1980, when the price of West Texas intermediate crude jumped from $44 to $88, measured in dollars of 2005 purchasing power. Moreover, the average price of unleaded regular has jumped 32¢ in just three weeks, to $2.61 per gallon on Aug. 22. That's the fastest three-week rise since the Energy Information Administration began its weekly tracking in 1990.

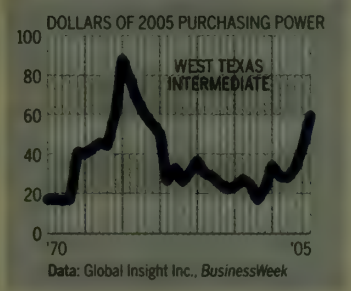
What's crucial to the second half is how consumers, businesses, and Federal Reserve policy adjust to this rapid and permanent shift in fundamentals at a time when the economy is more vulnerable to any kind of shock than it was in 2004. Those reactions will determine whether the economy can skim past the latest oil spike, as it did during the past two springs. Excessive caution or a few missteps could compound the drag from higher oil prices.

Bear in mind that an oil shock can hit the economy in two ways. It can cut into spending as consumers and businesses shift income and profits toward higher energy bills and away from other purchases. Or the added cost can trigger faster inflation, pushing interest rates up further and complicating the Fed's task of managing the economy. Right now, most of the market focus is on the former, while the inflation risk is generally being ignored.

ANY ANALYSIS HAS TO BEGIN with consumers, who now shell out about $50 every time they fill up. The burden on lower-income households, where necessities take up a greater share of outlays, has become particularly heavy, and sluggish August reports from retailers show some strain on households during the important back-to-school shopping season.

Before this summer, consumers adjusted pretty well to costlier fuel. Price jumps in the spring of both 2004 and 2005 caused some temporary weakening in the pace of spending, and buying patterns as well as readings on consumer confidence are sure to sag in coming months. But while households bounced back after the two previous soft patches, often with gusto, this time around the rebound could be much more restrained, especially if oil stays at its lofty level.

THE REAL PRICE OF OIL: NOT SO TAME ANYMORE



Data: Global Insight Inc., *BusinessWeek*

That's because consumer fundamentals will be far less robust as 2005 winds down than they were at the start of 2005 or in 2004. Previously, historically low interest rates, the tail-end stimulus of the 2003 tax cuts, improving job markets, solid income growth, and record wealth all combined to give households the means to overcome higher energy bills. Inflation-adjusted consumer spending has grown nearly 4% over the past year. Had oil and gas not spiked, outlays would most likely have grown closer to 5%.

NOW, THOUGH, HOUSEHOLDS face bigger head winds. Tax cuts are a thing of the past, and a declining federal deficit for fiscal 2005 means government finances are no longer stimulating growth.

Moreover, the Fed is set to continue raising interest rates. Last year at this time, the Fed's target federal funds rate—a mere 1.5%—helped to ease the pain of $50 oil. Now, with oil at $65, the funds rate is at 3.5% and set to go higher. And while it has not happened yet, at some point long-term rates—including mortgage rates—will rise as well. That means housing and home prices will offer less support to consumer spending and wealth.

While consumers gripe about gas prices, many have

not yet changed their travel plans. The American Automobile Assn. estimates that the number of people traveling 50 miles or more over the Labor Day weekend will increase by 0.9% from last year. The number traveling by car is also expected to be up slightly.

Why no letup? Probably the best explanation is that consumers' fortunes and sense of well-being are tied more closely to the labor markets than to anything else. True, in June households spent $58 billion more on energy than they did the year before. But their income from wages and salaries rose by nearly $400 billion.

THE IMPORTANCE OF THE JOB MARKET highlights the idea that the response of businesses to the new surge in energy costs will be just as crucial to the outlook as the response by consumers. Another round of corporate caution may not only mean a drag on capital spending or a squeeze on profit margins or productivity growth. Any new hesitancy could also affect jobs and incomes, exacerbating energy's pressure on household budgets.

Through most of August, the labor markets look strong, with new weekly claims for jobless benefits trending lower. Based on that, August payrolls probably posted another solid advance. As long as companies are coping, any pullback by consumers in the second half will be short-lived. One caution flag: The trend in orders for capital goods other than aircraft has flattened out in recent months after a period of steady strength (chart).

Interestingly, higher energy costs are now viewed more as a drag on growth rather than as pressure on inflation, as competition has made it more difficult for companies to pass them along. Back in the 1970s, core inflation, which excludes energy and food, moved almost in lockstep with total inflation. But thus far in 2005, core inflation is actually down.

Moreover, companies have been absorbing the added fuel bills with little negative impact on profits. Some of that may well reflect success in passing along the higher costs, especially in the service sector. But more likely, solid demand has boosted total revenues for most industries, while strong advances in productivity have helped corporations to control their costs.

The danger is that the pricing constraints of recent years could break down, allowing inflation to broaden. Already, labor markets are tightening, which is likely to spur faster wage growth, at a time when productivity gains are unlikely to be as strong as in the past. If companies do begin to have greater success at passing along their higher fuel costs, then the key question heading into 2006 will not be whether $65 oil cripples the economy. It will be how the economy and the Fed cope with a significant upward shift in inflation. ■

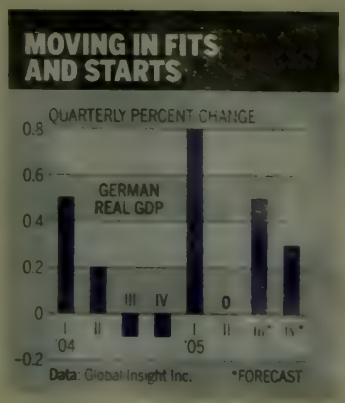
GERMANY

A Rally With Little Staying Power

THE GERMAN ECONOMY stalled in the second quarter, although recent signs indicate it is picking up again. Even so, any second-half rebound is unlikely to touch off a self-sustaining economic recovery.

The detailed figures for second-quarter real gross domestic product issued on Aug. 23 showed zero growth from the first quarter. An improvement in exports was overshadowed by a surge in imports, creating a net drag from foreign trade. As implied by the jump in imports, domestic demand improved. But the rise in spending at home was not provided by consumers. Private consumption fell by 0.3%. Rather, the government and businesses carried the load. Public spending and capital-equipment outlays each grew 0.6%.

Improving prospects for exports, as well as a successful effort by German companies to rein in labor costs, have spurred businesses to ramp up their investment. Capital outlays have increased 5.2% from the previous year, vs. 0.6% for the overall economy. And an IFO Institute survey of analysts around the globe showed a brighter outlook for world growth in the second half of 2005. Of course, growth in German exports and capital spending will depend on whether oil prices squelch the global rebound.



Politics may also spur growth in the second half. Voters are expected to kick out Chancellor Gerhard Schröder at the Sept. 18 national elections. The Christian Democrats' candidate, Angela Merkel, holds a double-digit, albeit narrowing, lead. If her party wins, she will push to increase the value-added tax (VAT) to 18%, from 16%, beginning in January. In response, consumers will likely make big-ticket purchases during the second half of 2005 to avoid paying the extra tax next year.

Unfortunately, a corresponding decline in consumer spending in early 2006 would be likely. On top of that, a Christian Democrat victory would likely mean further economic reforms, such as the scaling back of restrictive labor laws. Those changes would cause short-term pain for households at the gain of improving the long-term economic prospects of the country. ■

–By James Mehring in New York

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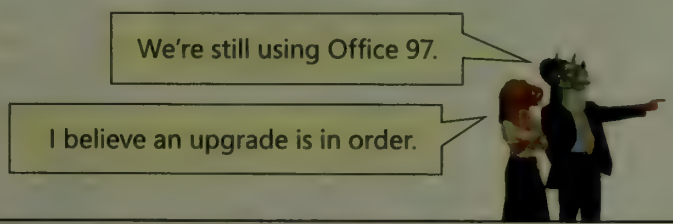

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REAL ESTATE

SHARKS IN THE HOUSING POOL

Deed thieves, property flippers, equity strippers—these con artists are duping banks and homeowners

BY DEAN FOUST AND BRIAN GROW

BY MOST MEASURES, Matthew B. Cox would appear to be a mortgage lender's dream customer. The 36-year-old former Tampa resident had once worked in the mortgage business, so he understood intimately what it took to qualify for a loan. And Cox threw plenty of business at mortgage lenders in Florida, and then Georgia: An aspiring real estate investor, Cox took out $3.7 million in mortgages to finance his apparently ever-growing stable of houses.

But in reality, Cox was the industry's worst nightmare. Federal law enforcement officials say that Cox—a.k.a. Michael Shanahan, David Freeman, and Gerald Cugno—along with his girlfriend, Rebecca M. Hauck, masterminded a massive mortgage fraud that ensnared at least 10 different lenders, including Bank of America Corp. and SunTrust Banks Inc. Using nearly a dozen stolen identities, the pair forged "deeds of satisfaction" to convince banks that they had paid off loans for—and thus owned—homes that, in fact, they were renting from the true owners.

With these fake documents, Cox then persuaded banks to lend him millions beginning in 2002 and into 2004—millions he and his girlfriend subsequently absconded with. So brazen was Cox that he left some of the mortgage brokers who closed his loans in Florida a copy of his novel-in-progress, titled *The Associates*—little more than a barely fictionalized account of his escapades. Cox and his girlfriend are now on the lam, their faces pla tered on wanted posters distributed bankers, mortgage brokers, and real esta agents. "We want to catch him so we c put him on trial," says David E. Nahmi U.S. Attorney for the Northe District of Georgia.

Welcome to the dark side of t housing boom. While the plun in interest rates has triggered explosion of housing and mo gage activity, allowing millions Americans to buy and refinan houses, it has also given rise to unprecedented wave of frau The FBI says the number of suspect fraud incidents reported by federally cha tered banks, which underwrite rough half of all mortgages, has soared nea fivefold since 2000, to 17,700 last year, a

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42 A high price for Hilfiger?

is set to top 20,000 cases this year. No one has exact figures on how much the fraud is costing banks and homeowners, but analysts say the losses could well amount to more than $2 billion a year.

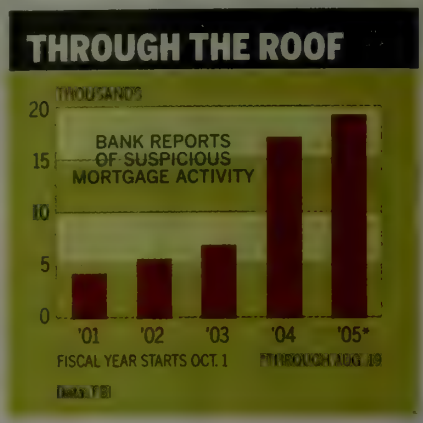
And here's the rub: With the property market at last showing signs of cooling off in some parts of the country, the banks may suddenly find themselves less insulated from mortgage scams. Says William Matthews of the Mortgage Asset Research Institute: "In a flat or declining market, the bodies are going to rise to the surface more quickly."

Why the rise in fraud? Chalk it up in large part to the sheer number of mortgages banks are handling nowadays. The plunge in rates has goosed mortgage volume from roughly $800 billion a year in the mid-1990s to more than $2.6 trillion now. To meet demand, lenders hired tens of thousands of inexperienced staffers at the same time they were working feverishly to cut the time needed to close loans. As a result, experts say lenders sometimes cut corners on the due diligence that could have caught some of these frauds.

CUTTING CORNERS

COMPOUNDING MATTERS is that lenders, to cut costs, have outsourced the origination of most mortgages to independent mortgage brokers, who now initiate more than two-thirds of all home loans—meaning that banks don't know borrowers the way they did in decades past. Banks "aren't meeting the borrower face to face anymore," says Arthur J. Prieston, chairman of Prieston Group, a Novato (Calif.) provider of fraud insurance and training. "There has been less concern for the quality of the loan and more for the quantity."

At the same time, con artists have become more sophisticated in their tactics—through their use of identity theft or their ability to detect vulnerabilities in the mortgage process. For instance, some have exploited the logjams that have occurred in overworked county deed offices. Ownership titles that took days to be recorded now take weeks or months, and fraudsters know this leaves lenders confused about who the true owner is. In Douglasville, Ga., a fraud ring refinanced a property in quick succession with three different lenders before selling it. As a result, four lenders now claim rights to the first lien—and the title insurers, which include Fidelity National Title Insurance Co., could be on the hook for the losses. "We're scared to death" of the potential for similar frauds elsewhere, says Fidelity counsel Robbie J. Dimon.



Some scams use sophisticated rings of buyers who flip a property at inflated prices among themselves before absconding with the loan proceeds. That was the case in Stone Mountain, Ga., an Atlanta suburb, where a 15-person fraud ring—a group that included corrupt mortgage brokers, closing attorneys, fake buyers, and an identity thief—flipped at least 100 houses in three neighborhoods over a three-year period, pilfering roughly $20 million bank funds before being busted last yea

The problem could get worse f banks before it gets better. As long prices were rising sharply in housing h spots such as Boston, Washington, D. and Southern California, banks duped fraudsters were often able to cut th losses—or even co out whole—by selling the default property back into rising market. But i unlikely that ban can count on risi valuations to b them out of bad loa And while the ban have been securit ing their mortgag and selling them third parties, they a still on the hook f part of the loan if it goes bad.

Homeowners are taking it on the chi too. In Utah, some state officials belie rampant fraud has compelled lende there to boost mortgage rates by an ext quarter-point to help cover their loss When property-flipping scamsters dri up house prices, property-tax hikes are far behind. And when scams come unra eled, home values can plummet. By t time the Stone Mountain fraud ring w busted in 2004, property values h plunged from an average of $280,000 $180,000—and several of the flipp houses remain vacant, their lawns co ered in weeds. "These are homes with love," says Ann D. Fulmer, a mo turned-fraud-hunter who helped autho ities bust the gang (sidebar).

In parts of the country where housi prices have risen especially quick homeowners have become direct targe

OVER THREE YEARS, 100 ATLANTA HOUSES WERE FLIPPED BY A FRAUD RING

Steal Estate

The hot housing market has spawned an epidemic of mortgage fraud. Four common scams:

THE SERIAL FLIP

A fraud ring buys a residential property, then resells it over and over to different members of the same gang. After artificially driving up the property's value in this way, the ring absconds with the proceeds from the final mortgage, leaving the house for the bank to deal with.

THE HELPING HAND

Scamsters scan the courthouse listings to find homeowners who have defaulted on their mortgage and face foreclosure. They promise to help these owners save their home. Instead, using a blizzard of confusing paperwork, they con the rightful owner into deeding over their house

THE FIXER-UPPER

Con artists convince naïve owners of run-down homes, often the elderly, that they will help them refinance their property, with the promise that the new funds will be used to repair the place; instead, the scammers abscond with the profits and never do the work.

THE PAYOFF

Fraudsters with fake identities and forgery skills file bogus "deeds of satisfaction," normally used by overburdened banks to ensure that a mortgage has been paid off. Then the scammers take out new loans on the property in question—which they often don't own—and simply disappear.

of an increasing range of scams. There has been an explosion of "equity stripping" schemes, in which elderly or blue-collar homeowners who have fallen behind on their mortgage payments and are facing foreclosure are preyed on by scammers, who often get their leads from the mortgage-default notices that banks are required by law to file with the local courts. These legal notices "just provide a road map for scammers," says Manuel Duran, a Los Angeles lawyer who has represented fraud victims.

JUST SIGN HERE

IN THESE SCAMS, the con artists approach homeowners, offering to help them refinance—and thus stave off foreclosure. But their real intent is to steal the equity that these homeowners have built up over the years—either by duping the owner into signing papers in which they transfer ownership or by charging tens of thousands of dollars in exorbitant fees. The former happened to Michelle Roberts-Taylor, a 40-year-old transit supervisor who lives near Washington, D.C. After falling behind on her mortgage last year, Roberts-Taylor received a phone call from a mortgage broker who promised to help her refinance the mortgage at a lower rate. It was when Roberts-Taylor received an eviction notice that she realized she had unwittingly signed over her home to the broker. This fraud, unlike most others, had a relatively happy ending: Roberts-Taylor hired an attorney who was able to win an $85,000 settlement last December from the broker.

Will the fraud wave recede if the housing market cools off? Perhaps over time, but the banks could be in for a rough ride in the short term. Besides the potential hit from slowing home prices, an end to the boom also could prompt scammers to cash out. And some of these guys have a lot of skin in the game. Earlier this summer, a grand jury in Springfield, Ill. indicted two men for taking out fraudulent, inflated mortgages on more than 150 properties. The scheme cost lenders $8 million in losses. And they know there are plenty of other big scams out there just waiting to hit. ■

INVESTIGATORS

The Accidental Mortgage Detective

It was the battered red Ford Taurus with the missing hubcap that made Ann D. Fulmer suspicious. The car was parked outside a house that, along with others in her leafy Stone Mountain, Ga., neighborhood, had sold for remarkable prices back at a time—the late '90s—before the real estate boom really took off.

Fulmer, a stay-at-home mom with a law degree, decided to investigate. She combed through deeds at the county courthouse. What she found was a spiderweb of mortgage fraud: Houses were being bought and sold by the same people—sometimes nearly doubling in price in the process. Fulmer passed on the intelligence to law enforcement. By 2002 the mortgage-fraud gang was out of business and its ringleader behind bars.

SUSPICIOUS Fulmer found a spiderweb of fraud in her Georgia neighborhood

Today, amid an explosion of real estate fraud, Fulmer's gumshoe skills are in hotter demand than ever. In March the 48-year-old onetime homemaker was a keynote speaker at the Mortgage Bankers Assn.'s National Fraud Summit. In April she briefed FBI agents on the painful personal costs of mortgage fraud. And this month, InterThinx, a St. Louis maker of fraud-detection software, hired Fulmer as a vice-president. Her doggedness and attention to detail, say investigators, are shining a bright light on an oft-ignored crime. "She's a driving force," says John Coliano, supervisory special agent in the FBI's Baltimore office, who oversaw its mortgage-fraud investigations until July.

Fulmer comes well-equipped for the task. A graduate of the University of Akron School of Law, she defended insurance companies against arson and fraud in the late 1980s. After several years at home with her children, Fulmer began her one-woman mortgage-fraud odyssey in 1997, then joined forces in 2000 with Alicia Sheppard, another homemaker who uncovered fraud in her Gwinnett County (Ga.) neighborhood. The duo set up the Georgia Real Estate Fraud Prevention & Awareness Coalition. Their goal: to show that mortgage fraud is not just a blemish on banks' bottom lines—but a swindle on local communities.

Taking down scammers has become a personal campaign for Fulmer. Her pulse seems to quicken as she drives through fraud-plagued neighborhoods. In the Mountain Oaks and Waters Edge subdivisions, east of Atlanta, she waves property-tax records showing how, over the past five years, a 15-person fraud ring drove up the price of 100 bungalows and colonials before absconding with the loan proceeds. Some of the houses still sit vacant. On Aug. 24 the gang's mortgage lawyer, Chalana C. McFarland, was sentenced to 30 years in prison, which could be appealed.

Hunting fraudsters can be a spooky business. Fulmer says they have tailed her, a claim the FBI confirms. When that happens, she says, "I put on my best soccer-mom smile and drive 25 miles per hour." She clearly has no intention of backing off. This month, Fulmer handed over new data to the Georgia Attorney General's office: property records showing that one local outfit had bought 88 houses in DeKalb County since 2001. More than half are now in foreclosure—a telltale sign of a potential fraud ring. "For every group you put away, two or three more pop up," says Fulmer. "It's like a Hydra."

–By Brian Grow in Atlanta

THE INTERNET

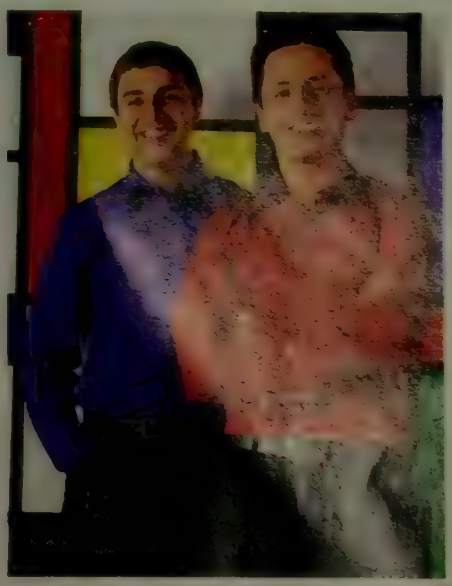
GOOGLE'S GRAND AMBITIONS

Its lips are sealed, but its moves rattle everyone from Microsoft to eBay

IN YEARS PAST, MICROSOFT CORP. could freeze competitors and send investors scurrying just by uttering the name of a market it fancied. Today, Google Inc. is the 800-pound octopus that is filling potential rivals with dread and envy.

In typical Google fashion, the company chose an unusual moment—the sleepy doldrums of mid-August—to shake up the tech world with a flurry of announcements. First, Google confirmed that it had quietly acquired mobile-phone software startup Android Inc. Then came the surprising news that it would add $4 billion to its cash war chest with a secondary stock offering. And then on Aug. 24, the search giant announced it was getting into the instant messaging and Internet telephony businesses. No wonder tech watchers from Silicon Valley to Bangalore are all wondering the same thing: What the heck is Google up to?

No point asking the Mountain View (Calif.) company. Google, as usual, is about as talkative as a telephone pole. But in dissecting the company's spate of recent hires, investments, and acquisitions you can catch tantalizing glimpses of where the search giant could be headed. Talk about ambition. Google appears to be contemplating forays into everything from Wi-Fi Internet access and mobile devices to operating systems and e-commerce.



DEEPER POCKETS Page and Brin plan on having $4 billion more to shop with

Google faces serious challenges of course, not least because it is playing catch-up in some of these fields. But if the company's outsize ambitions come to fruition, Google would suddenly be on a collision course with some pretty heavy hitters. The company is already challenging Microsoft and Yahoo! Inc. Now it seems to be getting ready to stomp on the turf of such giants as eBay, Motorola, Nokia, SBC Communications, and Verizon. And if you're a tech startup working similar technologies as the savvy folks in the Googleplex, you have two basic choices: Plan to be acquired—or get run over. "There is a new fear and caution about how Google will use its war chest," says Chris Shipley, producer of the DEMO Conference, where startups strut their stuff.

If the search behemoth goes ahead with its myriad initiatives, it will be Google vs. Everyone. Here's a glimpse of where Google may be headed:

GOOGLE VS. VERIZON Playing a role in how consumers connect to the Net is an important step for online giants. It helps deepen the link between Web surfers and Internet companies while providing a window for these outfits to showcase products and services. Google clearly covets such a role, but it has shown no interest in mimicking the access businesses of other tech titans—piling up millions of subscribers like America Online or following Yahoo's lead of partnering with telecom gia

Google may be showing its hand this arena with a couple of little-noti business moves. In April, Google tean up with wireless startup Feeva Inc. sponsor a Wi-Fi hot zone in San Fran co (page 39) in which Google appear the start page. Google says this is all p of its mission to make access to inform tion more readily available, but it w comment on other Wi-Fi moves. So analysts, though, believe it would m perfect sense for Google to bankroll W access points, not only allowing Googl get more users but also to target ads b ter locally—a huge growth area. "Goo wants there to be more search momen says Esme Vos, editor of the MuniW less Weblog and a consultant to cities ploying Wi-Fi solutions. "This wo make a lot of sense."

Meanwhile, in July, Google investe Current Communications Group LL company that offers broadband acc over power lines. The company has b rolling out its service to a few market the U.S., including Cincinnati. Veri

> There is a new fear and caution about how Google will use its war chest.
>
> *— Chris Shipley, producer of the DEMO Conference, where tech startups strut their stuff*

and SBC take note. These moves show Google is "really interested in affording people the greatest possible access and speeds," says Scott H. Kessler, an equity analyst at Standard & Poor's.

GOOGLE VS. MOTOROLA Former insiders say Larry Page—who, with Sergey Brin, founded the company—has ruminated in years past about offering a Google mobile phone, allowing users to search the Net easily and get data from the device. Although a fiercely competitive space crowded with companies like Motorola and Nokia, the barriers to entry are getting lower all the time, thanks to a passel of contract manufacturers from Taiwan and elsewhere eager to make phones cheaply for anyone interested in breaking into the market.

At the least, recent acquisitions show the company is working on a software platform for mobile phones. In July, the company snatched up the secretive startup Android, founded by Andy Rubin. Rubin's previous startup was Danger Inc., which developed the popular Hiptop communications device. Although little is known about Android, one person familiar with the company says its engineers at one point had been working on an operating system for mobile phones.

Google also buttressed its mobile-software arsenal with its May acquisition of Dodgeball. The startup has developed social-networking software for mobile devices. A Dodgeball user, for instance, could contact a group of friends in a particular vicinity with a single message on a mobile phone. Google declines to comment on how it intends to utilize the Dodgeball and Android technologies.

GOOGLE VS. MICROSOFT Google has been poaching talented engineers with a wealth of expertise in two Microsoft strongholds: browsers and operating systems. One source familiar with the company says some of these hires are working on an Internet operating system that might run on top of Linux and could compete with Microsoft's Windows franchise. Although any such offering may be years out, it seems plausible based on the talent Google has lured. In recent years, it has hired several architects of Microsoft's .Net strategy—an attempt to expand its operating system dominance to the Internet. If Google is indeed contemplating an OS, it would amount to an attack on the very foundation of Microsoft.

Google's raid on browser talent has been just as important. In the past year it has hired several top developers of the Firefox browser, a well-regarded but distant challenger to Microsoft's Internet Explorer. "If I'm Microsoft, I'm watching these guys co-opt my desktop," says Michael Gartenberg, an analyst at Jupiter Research. "I would be concerned about... the sheer power of their presence."

GOOGLE VS. eBAY Google has not wowed anybody in online commerce so far. Its shopping search site Froogle has not distinguished itself from the pack, and it garners only a fraction of the visitors that go to competing services, such as Yahoo! Shopping. But Google concedes that it is working on an online payment platform—which could put it in direct competition with eBay's PayPal service.

Another possibility: Google could eventually allow individuals to post items for sale on Froogle. Google's recent hiring of Louis Monier, former director of eBay's advanced technology research, has only added to such speculation.

It's a good bet Google is pondering all of these possibilities and more. The real question is what projects will get the resources inside Google and see the light of day. With uncertainty like that, Google will have the rest of the tech world on edge for some time to come. ■

–By Ben Elgin in San Mateo, Calif., with Arik Hesseldahl in New York

COMPUTER MAKERS

NOTEBOOKS WITHOUT WIDE MARGINS

As competitors crowd the market, prices are dropping, and profits are under pressure

FOR THE PAST FEW YEARS, PC makers have relied heavily on one segment to drive earnings: notebook computers. Indeed, customers' love of portability has created a roaring engine in an otherwise dismal industry. "Notebooks are nicely profitable," Hewlett-Packard CEO Mark V. Hurd told analysts this month, after announcing HP's best PC results since 2001.

But how long will the good times last? Many see signs that this $79 billion market may follow the same script as the once-lucrative desktop PC business. Even though Gartner Inc. expects notebook revenue growth to increase 15.9% this year, up from 14.5% in '04, it's expected to slow to 12.6% next year.

That's in part because prices are dropping fast. Already, PC makers are trying to woo buyers with no-frills laptops priced as low as $499, or $399 with rebates. And competition is heating up, with scrappy players such as Acer, Averatec, and Gateway clearly prepared to accept lower gross margins and make it up on volume. Roger D. Kay, president of EndPoint Technology Associates, figures operating profits on notebooks are still around 9%, vs. 5% for a desktop. "But when the bloodbath is over," he asks, "are notebook margins going to be any better than desktop margins? Probably, but not by much."

Blame a dangerous double whammy, says First Albany Corp. analyst Joel M. Wagonfeld. Not only are profit margins declining as makers run out of room to cut costs, but cheapo models are expected to drive most of the sales growth. That means even if margins stabilize, PC makers will realize even fewer dollars of profit per unit.

And with much of the global demand coming from price-sensitive emerging markets like China, the average notebook price is expected to fall to $717 in 2008, says IDC, down from $1,050 today. Assuming, as many analysts do, that operating margins will fall to 6%, that leaves a meager $50 profit. "Most of the growth is coming from less-profitable markets and lower-priced products," says Wagonfeld. "That's why, despite great unit growth, you have anemic revenue growth."

Meanwhile, players at the low end of the market are expected keep the margin pre sure cranked up. Ha ing merged with lo price desktop mak eMachines Inc., Gateway Inc. is applyi its thrifty ways to the notebook mark And Asian players willing to accept lou margins for more share are muscling One is Averatec Inc., a three-year-old ou based in Santa Ana, Calif., backed by t same Asian manufacturer, TriGem Co puter Inc., that funded eMachines. Averat President Saeed Shahbazi says the comp ny already makes do with that miserly 6 operating margin on its notebooks, whi are mostly aimed at the current sweet sp of the market: so-called "thin and ligh machines costing around $1,000.

HUNT AND PECK Low-end makers are exerting pressure

CORPORATE SLOWDOWN

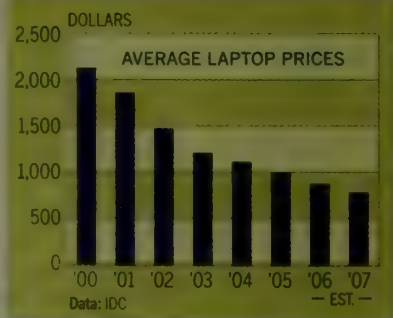
COMPETITION AND falling prices are a fatal formula for PC makers as long unit growth keeps pace. But many an lysts fear growth is bound to slow at son point. While sales to consumers rema brisk, Leslie Fiering, an analyst wi Gartner, says a three-year buying bin by corporations has started to slow. "T replacement cycle is tapering off," adds. "And as demand comes down, n everyone is going to be able to mainta enough margin to remain viable."

PC makers say they're unfazed. Th note that buyers tend to purchase plen of high-margin add-ons, including ser ice contracts, additional batteries, ar docking stations. Moreover, there's st room to innovate and earn a premiu from customers. Gateway this week a nounced a new the protection service th helps corporate managers locate lost stolen laptops. HP's r cently updated mode have a feature that le users play a CD or DV without waiting f Windows to boot up.

Few expect an a out price war th Christmas. That's d in part to shortages certain components, which could lim production in the coming months, ar price hikes on other parts. Still, there's li tle doubt that notebook profits are hea ing in the wrong direction. The only que tions are how fast it's happening and ho bad the bloodletting will be. ■

–By Peter Burrows, with Louise L in San Mateo, Calif., and Bruce Einho in Hong Ko

THE NOTEBOOK SPIRAL



THE INTERNET

WI-FI WITH ITS OWN ZIP CODE

As more municipalities set up wireless networks, a fast-moving business emerges

ADDISON, TEX., JOINED the nation's tech elite on Aug. 23. With the flick of a switch, Mayor Joe Chow turned on a city Wi-Fi network that covers all 4.5 square miles of the Dallas suburb. Now, Addison's 00,000 residents can buy fast wireless Web access from startup RedMoon Inc. for ust $16.95 a month—a far better deal than nost phone or cable broadband offerings.

As towns across the country launch vireless broadband networks to bring afordable Web access to their residents, ompanies from tiny RedMoon to heavyveights such as Hewlett-Packard Co. are ockeying to become their partners. Their notivation: Getting in on the ground oor of a potentially fast-growing busiiess while creating an alternative to the Bells and cable outfits that control most of he country's broadband pipes.

On Aug. 18, Wireless Philadelphia, the onprofit running that city's Wi-Fi netvork, chose HP and EarthLink Inc. as fialists to build and manage its $18 milion system. Minneapolis is now eviewing proposals from EchoStar Communications Corp. and Sprint Nexel Corp., among others, to build and run a $15 million to $35 million citywide etwork. Google Inc. sponsors a wireless ot zone in San Francisco's Union Square, and analysts wonder if the Inernet giant will bid for the city's new Vi-Fi project.

BIG BUCKS

THE MUNI WIRELESS business is still in ts infancy. But with 300 cities launching or soon to launch Wi-Fi networks, the narket could yield roughly $200 million n revenues a year, according to market racker Yankee Research Inc. Although Vireless Philadelphia has yet to negotiate a final price with its winning bidder, its business plan calls for spending $50 million over five years. Many cities and their corporate partners haven't yet set prices. But Philadelphia for now envisions selling Wi-Fi at less than $20 a month and just $10 a month to low-income residents.

Cities may want Wi-Fi to bridge the digital divide. But many of their potential partners—such as Sprint, MCI, and satellite TV provider EchoStar—are old rivals to the Bell and cable companies and see wireless as a way to compete with their enemies. While Internet service providers such as Earthlink can still make deals with the Bells and cable outfits for delivery of services, "it's essential now for [such] companies to figure out an alternative way to get into people's homes," says Ronald A. Sege, chief executive of Tropos Networks, a wireless-broadband equipment vendor in Sunnyvale, Calif.

ADDISON, TEX. Residents can log on anywhere in town

Equipment makers also want to get a toe in the door. Hewlett-Packard, which long has provided technology infrastructure for telecom companies, views wireless broadband as the communications system of the future. "It's a natural evolution for HP to move into this space," says William J. Mutell, senior vice-president of worldwide public-sector solutions. The Palo Alto (Calif.) company is bidding to build Wi-Fi networks in six cities and currently operates systems in St. Cloud, Minn., and Franklin, Tenn.

The rush to build muni wireless zones has got the Bell and cable companies plenty worried. They have mounted lobbying campaigns in 14 states to bar local jurisdictions from creating their own networks, but have failed in all but one. In Congress, the issue will likely get ironed out as part of an impending overhaul of the 1996 telecom law. To fend off the Bell and cable lobbies, many cities are opting for outsiders to own their Wi-Fi network.

The new competition already may be having an effect: Verizon Communication Inc. just dropped its DSL pricing to $14.95 a month. Cities, meantime, see these networks as a necessity of the Information Age. "Just as with the roads of old, if broadband bypasses you, you become a ghost town," says Dianah L. Neff, Philadelphia's chief information officer. As more and more burgs rush to get connected, Techdom senses a potentially lucrative business in the making. ■

–By Catherine Yang in Washington, with Ben Elgin in San Mateo, Calif.

Look Who's Jumping Into Wi-Fi

PHILADELPHIA EarthLink and Hewlett-Packard are finalists to build a 135-square-mile citywide network, serving up to 1.5 million people

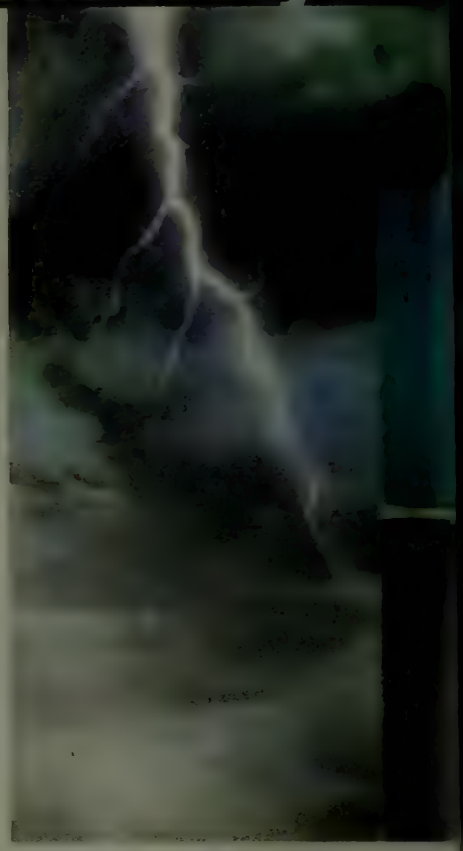
MINNEAPOLIS EchoStar is bidding against Sprint Nextel and EarthLink, among others, to build a 59-square-mile citywide Wi-Fi and fiber network, eventually serving 385,000 residents

LEXINGTON, KY. MCI is building a pilot network in the city's downtown, which could grow to serve 275,000 inhabitants

LAWSUITS

THE PAIN IS JUST BEGINNING

Why the Vioxx debacle will hobble Merck for years to come



Another corporate icon has been humbled. Long a Big Pharma powerhouse, Merck & Co. now looks likely to emerge from its Vioxx mess as a weakened version of its former self: a second-tier player among its rivals.

The fallout from the Aug. 19 Texas jury verdict is only beginning. The $253 million award is likely to bring on a torrent of new lawsuits, even as another ominous cloud gathers: The Justice Dept. is continuing a criminal investigation into Merck's handling of Vioxx. Should the probe result in convictions of current or former Merck executives, the odds of big punitive-damage awards in civil cases would increase. Then there's the biggest wild card of all: Do Vioxx users have an increased risk of heart attacks even after they stop taking the drug? While doctors say that's unlikely, data from a company study could show otherwise, potentially ballooning the number of plaintiffs and even jeopardizing the company's survival.

When Merck's team of lawyers began their opening arguments in a Texas courtroom in mid-July, they thought science would vindicate the company. Sure, Vioxx had been linked to heart attacks and strokes, which was why Merck stopped selling its blockbuster pain pill last fall. But there was no evidence, they argued, that Vioxx could have killed Robert C. Ernst, a 59-year-old triathlete who died in his sleep in 2001 after taking the drug for eight months. Just look at Ernst's autopsy, they said. The coroner concluded the cause of death was an irregular heartbeat known as an arrhythmia.

It turned out, of course, to be a costly misjudgment. A jury voted 10-2 that the arrhythmia likely was brought on by a clot and a sudden heart attack, and for that, Merck should richly compensate Ernst's widow, Carol Ernst. Merck will almost certainly see the massive verdict reduced and has a decent shot at prevailing in an appeal. But the decision is ominous. Ultimately, some analysts estimate that Merck's liability could soar to $50 billion.

FADING FASTER

INVESTORS WERE fretting well before the Texas verdict. Merck's biggest seller—cholesterol-lowering drug Zocor, with forecast sales of $4.4 billion this year—loses its patent protection next year. Now, management distraction and the financial toll of settling Vioxx suits seem likely to make it harder for Chief Executive Richard T. Clark to attract the best scientists or tie up with outsi companies for products to make up f that loss. "Even without Vioxx, Mer was fading," says Lloyd S. Kurtz, portf lio manager at Palo Alto (Calif.)-base Nelson Capital Management. "No maybe they fade faster."

Merck executives dismiss such tal arguing that the company is as strong it ever was. Merck's general couns Kenneth C. Frazier says estimates of th number of suits and Merck's potential l ability are "highly speculative." He ad that while the company didn't make i best case in Texas, management acte responsibly in its handling of Vioxx. " don't see this as an issue that in any wa cripples our mission going forward Frazier asserts.

Certainly, Merck can withstand a si able hit. The Whitehouse Station (N.J company had $14 billion in cash and in vestments as of June 30. Even at today post-verdict stock price of almost $28

Medicine Chest Full Of Worries

The Vioxx tab could swell to $50 billion under the following scenarios:

MORE JURY AWARDS

In the Texas case, the victim died of an irregular heartbeat. But in studies Vioxx has been linked to an increased risk of heart attacks and strokes, not arrhythmias. If those sorts of cases continue to succeed, Merck faces a troubling expansion of the plaintiff pool.

LINGERING VIOXX RISK

For now, the big threat is cases involving people who had a heart attack while on Vioxx. But Wall Street is awaiting data that will reveal whether patients remain at risk after they stop taking the drug. If so, the number of lawsuits, already at 4,100, could mushroom.

CRIMINAL CHARG

The Justice Dept. is investi Merck's handling of Vioxx. I government convicts curre former Merck employees o criminal wrongdoing, punit damage awards would be n likely in Vioxx civil trials.

share, Merck maintains a market capitalization of $60.5 billion. Merrill Lynch & Co. analyst David R. Risinger figures Merck will throw off $1 billion or more in cash after paying its dividend this year and in 2006. And the company could free up more bucks if it decides to cut that $3.3 billion annual dividend. While Merck has said it is committed to maintaining its dividend, Nelson's Kurtz says that payout is probably "unsustainable."

A dividend cut would be hard to avoid if Merck can't turn the tide in the courtroom. Right now investors and industry experts are flabbergasted that the company's lawyers did not effectively address the paper trail in the Texas case. Among the most damning exhibits: a 2000 memo that said a key study seemed to confirm fears about cardiovascular problems. Merck's Frazier says such memos reflect the fact that some data did raise initial concerns about Vioxx' cardiovascular safety. But he says subsequent analysis of other studies allayed those concerns. Next time, he says, Merck lawyers must explain that better to jurors. But he says Merck will continue to defend each case individually and will not negotiate a global settlement.

Even if Merck can manage to rack up some wins, many on Wall Street are bracing for a huge bill. Analyst Richard T. Evans of Sanford C. Bernstein & Co. estimates that the number of plaintiffs could easily hit 65,000. Under that scenario, and looking at the average payout in cases that involve heart attacks, damages could hit $30 billion. But that number may prove conservative if plaintiff's lawyers pile on with cases like Ernst's that don't involve proven heart attacks. Add in the increased likelihood of punitive damages, and the bill could go as high as $50 billion, says analyst David Moskowitz of Friedman Billings Ramsey.

LOOMING STUDY

BUT MERCK'S dilemma may be even more complicated. The company is still tracking the health of patients in a study it stopped last September when it pulled Vioxx. The company will begin collecting and analyzing data on those patients later this fall, although the company says it does not know when the follow-up information from that study, called APPROVe, will be ready for release. The key question is whether the risk from taking Vioxx persists for some period after people stop taking the drug.

Dr. Robert S. Bresalier, a member of the steering committee that led the APPROVe trial, says he suspects there is no lingering risk, and investors are betting he's right. But given the scientific uncertainties about exactly why Vioxx heightens the risk of heart attack, Bresalier says there is no way to be sure until the data are in. If there is some ongoing risk, Moskowitz of Friedman Billings Ramsey warns that the pool of plaintiffs could expand alarmingly. That, he says, could "call into question the survival of the company." Frazier says the company can't speculate on what that data will show but reiterates the company is financially strong.

When it comes to the Texas case, few people expect Merck to fork over anything close to $253 million. For one thing, state caps on punitive damages could slash that portion of the award to less than $2 million, says Victor E. Schwartz, a partner at Shook Hardy & Bacon and an expert on tort law. In addition, lawyers say Merck may have good grounds to appeal the verdict. Among the key issues: whether testimony of the coroner who performed the autopsy on Ernst was appropriate. Schwartz says a decision from the Texas Supreme Court several years ago requires judges to act as gatekeepers of the scientific evidence they allow into their courtroom. Frazier says the fact that the coroner testified that she believed there had been a clot despite an autopsy report which found no evidence of it made her opinion "unreliable scientific testimony."

The huge number of suits that Merck could eventually face has many wondering whether it will seek a global settlement. But such a settlement could be just as risky as Merck's strategy of taking on plaintiffs one by one. Consider the case of Wyeth and its liability from its diet drugs Pondimin (the "fen" in the fen-phen combo) and Redux. Wyeth agreed to settle claims in 2000, three years after pulling the drugs, which were linked to heart-valve damage. But of the 6 million people who took the drugs, many who sustained the most serious injuries passed on the settlement and sued anyway. And the settlement fund was overwhelmed by more claims than expected. So far, Wyeth, based in Madison, N.J., has taken $21 billion in reserves. Wyeth, says Columbia University Law School Professor John C. Coffee, "probably rues their decision to enter into a settlement."

FIRST OF MANY? The Texas verdict is likely to spark a rush to the courthouse

CLARK

ERNST

Merck isn't about to disappear anytime soon, of course. "I think they'll be able to buy their way out of this for $50 billion," says W. Mark Lanier, the attorney who represented Robert Ernst's widow. But whatever the ultimate figure, it's clear that Merck will be paying for Vioxx for a long time to come. ■

–By Amy Barrett in Philadelphia

IN DEMAND Tommy Hilfiger's stock price is soaring

RETAILING

THE NEXT FASHION VICTIM: INVESTORS?

Recent deals for apparel makers have pushed prices to worrisome levels

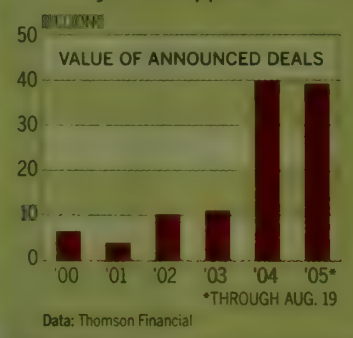
TOMMY HILFIGER IS HOT again, and it's not because of his red, white, and blue ensembles for the back-to-school set. No, this time the buzz is that the company itself may soon go on sale. Although no deal has yet hit the market, rumors of an auction soon after Labor Day have helped push the stock up 38% in August.

Hilfiger's no fashion leader, however. When it comes to mergers and acquisitions, clothes companies are all the rage. That has some smart investors worried that prices are getting too high. "It's a buying spree that doesn't seem to have a whole lot of pricing discipline," says Liz Claiborne Inc. CEO Paul Charron, a longtime acquirer who has done only two deals in the past two years, despite actively looking. "We see many overvalued properties on the market."

And prices just keep getting higher. James P. Fogarty, a managing director at restructuring advisers Alvarez & Marsal Holdings LLC and former CFO of apparel maker Warnaco Group Inc. and Levi Strauss & Co., says prices on recent deals have come in at a multiple of cash flow that's roughly 20% higher than what companies fetched just a few years ago. Investment bankers say some of the richest deals have closed at values as high as 15 to 16 times earnings before interest, taxes, depreciation, and amortization, or EBITDA, a common proxy for corporate cash flow. That's twice what public apparel makers command.

HOT NEW STYLE: M&A

Mergers and acquisitions are trendy in the apparel sector



Data: Thomson Financial

FLAT BUSINESS

THAT MIGHT NOT be so worrisome if the sector itself weren't weakening. Marshal Cohen, chief industry analyst for NPD Group Inc., expects clothing sales to grow 2.9% this year. But he thinks even that modest rate will slow as consumers snap up electronics over fashion and gas prices hit home.

Few apparel companies are as vulnerable as Hilfiger. Revenue from its U.S. wholesale business, most of it with department stores, dropped 29% to $684 million last year and is expected to fall another 30% this year. Hilfiger is further threatened by Federated Department Store Inc.'s pending deal to buy May Department Stores Co. and close 68 stores in 2006. Nor will clothing manufacturers be helped by Federated's expected expansion of its successful and high-margin private-label brands, including Inc. and Alfani, onto May's floor space. "I think Tommy's going to be a hard sell," says Maggie Gilliam, a former Wall Street analyst who runs consulting firm Gilliam & Co.

Caution aside, the run on fashion seems likely to continue. For one thing, suppliers hope that by bulking up, they can regain leverage on pricing with their now much bigger retail customers. Another reason: Private equity funds, which are flush, are in need of places to put their cash. In 2004 and the first half of 2005, such funds have raised $88 billion, according to Thomson Venture Economics.

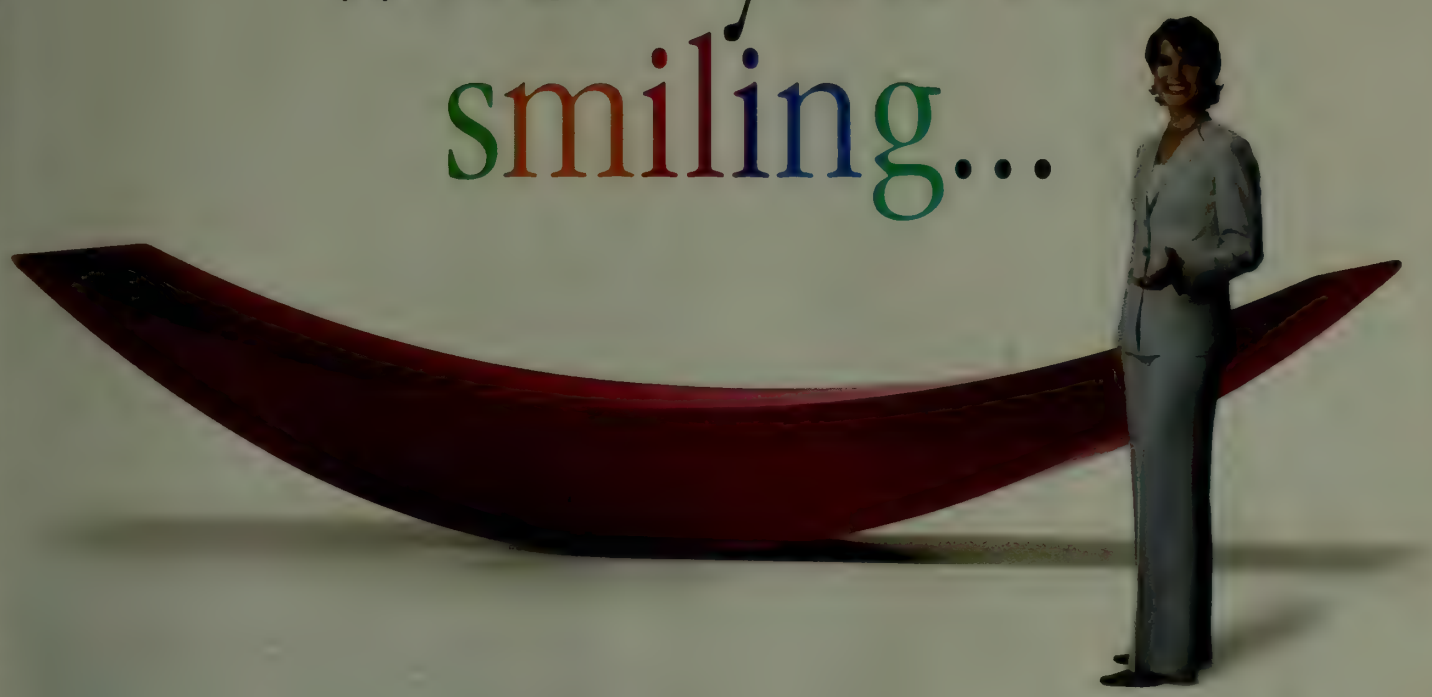
These funds are looking to apparel makers because of their low debt levels, modest capital-investment needs, and high margins, says Paul Altman, a vice president of Sage Group LLC, a Los Angeles investment bank specializing in consumer brands. In one recent deal, Altman says, he had bids from six interested buyers, though only five had even talked to company management.

Such fevered competition worries long-time apparel investors. Bear Stearns Merchant Banking has done quite well on a number of retail investments, including Aéropostale Inc., whose stock is up 34% since its 2002 initial public offering. It recently took a stake in 7 for All Mankind, a fashion jeans maker. But partner Bodil Arlander says that the $1.5 billion fund probably won't want to pay the price Hilfiger might fetch.

For Hilfiger, this may be a smart time to sell out. But if investors are tempted, they should be careful. Like that pricey shirt you just can't resist at the store, it may soon seem like it wasn't worth all that money. ■

–By Nanette Byrnes in New York

When you're smiling...



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EDITED BY MONICA GAGNIER

HEADLINER

BILL FORD JR.

ROUGH ROAD AHEAD

Ford Motor will lay out details of a "comprehensive" restructuring this fall, Chief Executive Bill Ford Jr. told reporters on Aug. 23. Ford is scrambling to restore profitability to its North American auto operations, plagued by sinking market share and steep materials and health-care costs. The unit lost $907 million pretax in the second quarter.

The carmaker already began eliminating 2,750 white-collar jobs this summer, or nearly 8% of its North American total, and may cut further. The CEO says Ford must tackle overcapacity and didn't rule out closing more assembly plants. Some analysts think Ford may close as many as four plants after labor talks in 2007.

The belt-tightening has spread overseas. Ford's Volvo Car unit on Aug. 23 said it will lay off as many as 1,500 workers in Sweden, or 5% of its global workforce. However, Ford's CEO vows that besides slashing costs, the restructuring will include positive initiatives. That might include pumping out more hybrids.

–Kathleen Kerwin

BEANTOWN'S NEW BOURSE

The **Boston Stock Exchange**, founded in 1834, is going high tech with help from some some big investors. Backed by **Fidelity Investments, Citigroup, Credit Suisse First Boston**, and **Lehman Brothers**, it plans to launch an electronic arm. The Boston Equities Exchange, or BeX, is set to open in 2006 and aims to grab 5% of all trades. Boston's move follows plans by the **New York Stock Exchange**, the **Philadelphia Stock Exchange**, and the **NASDAQ Stock Market** to add electronic platforms. But mutual funds have criticized the Big Board's plan for favoring its old-fashioned specialist firms. What's more, unlike publicly traded competitors, BeX won't face pressure from shareholders to raise transaction fees.

VEGAS CONDOS BY CLOONEY

Hollywood heartthrob George Clooney is teaming with **Related Cos.**, developers of the Time Warner Center in New York, to build a $3 billion hotel, condominium, and casino project in Las Vegas. Las Rambias will consist of 11 high-rise towers on 25 acres along the Harmon Avenue corridor, which cuts through the center of the city's famed Strip. Some 50,000 new condos are already under construction in Las Vegas, which is becoming a second-home destination for the world's well-to-do. Clooney, who'll be an investor, resident, and designer in the project, says he'll donate 25% of his profits to charity. Construction is to begin in mid-2006.

KMART: WHO KNEW WHAT?

A week after an arbitration panel cleared former **Kmart** Chairman and CEO Charles Conaway of mismanagement in a suit brought by former Kmart creditors, the **Securities & Exchange Commission** accused him of misleading investors about the retailer's finances before it filed for bankruptcy in 2002. The SEC brought similar fraud charges against former Kmart Chief Financial Officer John McDonald. The commission did not accuse the pair of fudging Kmart's numbers. Rather, it faulted them for failing to give investors a clear picture of the liquidity crisis the company faced in 2001. Lawyers for Conaway and McDonald said the two expect to be exonerated.

MORE MILEAGE FOR MOTOWN

The federal government on Aug. 23 proposed new rules that would raise the fuel economy of sport-utility vehicles, minivans, and pickup trucks by 8% from 2008 to 2011. The new regs would split trucks into six categories, each with its own mileage standard. Current rules demand a 21-mpg average for all the trucks an auto company sells. Detroit heaved a sigh of relief over the rules. Those big SUVs a pickups will only have to average 21.3 mpg by 2011, while the smallest SUVs mu improve mileage by 35%, to 28.4 mpg on average. The biggest trucks, including **General Motors'** Hummer H are still exempt because of regulatory loophole.

ET CETERA...

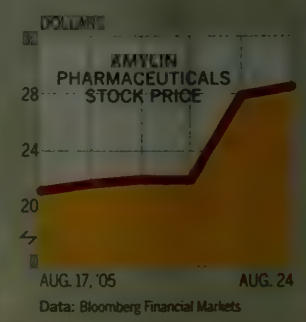
» Under a deal with New York Attorney General Eliot Spitzer, **AOL** will make it easier to cancel its service.

» Federal bankruptcy filing jumped 11%, to a record 467,333, in the second quarter from a year earlier.

» **Whirlpool** will acquire **Maytag** for $2.7 billion in ca and stock.

CLOSING BELL

Score one for the gila monster. Shares of Amylin Pharmaceuticals soared 31.6%, to $28.86, in the two trading days ended Aug. 24, after the company disclosed good trial data on a long-acting form of Byetta, a diabetes treatment derived from the lizard's saliva.



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Even when your restless mind keeps you awake, brand new Lunesta can give your body and mind the soothing sleep you need. Lunesta not only helps most people fall asleep fast, it helps you sleep all through the night. Peacefully, uninterrupted. Lunesta works quickly, so you should only take it right before bed. And Lunesta is non-narcotic, and the first and only prescription sleep aid approved for long-term use. Of course, do not use sleep medicines for extended periods without first talking to your doctor.

Now's the time to catch the sleep you need. If you've been hesitant to take a prescription sleep aid, be sure to ask your doctor about Lunesta.

Important Safety Information: Be sure you have at least eight hours to devote to sleep before becoming active. Until you know how you'll react to Lunesta, you should not drive or operate machinery. Do not use alcohol while taking Lunesta. All sleep medicines carry some risk of dependency. Side effects may include unpleasant taste, headache, drowsiness and dizziness. *See important patient information on the next page.*

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(eszopiclone)

1, 2 AND 3 MG TABLETS

Please read this summary of information about LUNESTA before you talk to your doctor or start using LUNESTA. It is not meant to take the place of your doctor's instructions. If you have any questions about LUNESTA tablets, be sure to ask your doctor or pharmacist.

LUNESTA is used to treat different types of sleep problems, such as difficulty in falling asleep, difficulty in maintaining sleep during the night, and waking up too early in the morning. Most people with insomnia have more than one of these problems. You should take LUNESTA immediately before going to bed because of the risk of falling.

LUNESTA belongs to a group of medicines known as "hypnotics" or, simply, sleep medicines. There are many different sleep medicines available to help people sleep better. Insomnia is often transient and intermittent. It usually requires treatment for only a short time, usually 7 to 10 days up to 2 weeks. If your insomnia does not improve after 7 to 10 days of treatment, see your doctor, because it may be a sign of an underlying condition. Some people have chronic sleep problems that may require more prolonged use of sleep medicine. However, you should not use these medicines for long periods without talking with your doctor about the risks and benefits of prolonged use.

Side Effects

All medicines have side effects. The most common side effects of sleep medicines are:

- Drowsiness
- Dizziness
- Lightheadedness
- Difficulty with coordination

Sleep medicines can make you sleepy during the day. How drowsy you feel depends upon how your body reacts to the medicine, which sleep medicine you are taking, and how large a dose your doctor has prescribed. Daytime drowsiness is best avoided by taking the lowest dose possible that will still help you sleep at night. Your doctor will work with you to find the dose of LUNESTA that is best for you. Some people taking LUNESTA have reported next-day sleepiness.

To manage these side effects while you are taking this medicine:

- When you first start taking LUNESTA or any other sleep medicine, until you know whether the medicine will still have some effect on you the next day, use extreme care while doing anything that requires complete alertness, such as driving a car, operating machinery, or piloting an aircraft.
- Do not drink alcohol when you are taking LUNESTA or any sleep medicine. Alcohol can increase the side effects of LUNESTA or any other sleep medicine.
- Do not take any other medicines without asking your doctor first. This includes medicines you can buy without a prescription. Some medicines can cause drowsiness and are best avoided while taking LUNESTA.
- Always take the exact dose of LUNESTA prescribed by your doctor. Never change your dose without talking to your doctor first.

Special Concerns

There are some special problems that may occur while taking sleep medicines.

Memory Problems

Sleep medicines may cause a special type of memory loss or "amnesia." When this occurs, a person may not remember what has happened for several hours after taking the medicine. This is usually not a problem since most people fall asleep after taking the medicine. Memory loss can be a problem, however, when sleep medicines are taken while traveling, such as during an airplane flight and the person wakes up before the effect of the medicine is gone. This has been called "traveler's amnesia." Memory problems have been reported rarely by patients taking LUNESTA in clinical studies. In most cases, memory problems can be avoided if you take LUNESTA only when you are able to get a full night of sleep before you need to be active again. Be sure to talk to your doctor if you think you are having memory problems.

Tolerance

When sleep medicines are used every night for more than a few weeks, they may lose their effectiveness in helping you sleep. This is known as "tolerance." Development of tolerance to LUNESTA was not observed in a clinical study of 6 months' duration. Insomnia is often transient and intermittent, and prolonged use of sleep medicines is generally not necessary. Some people, though, have chronic sleep problems that may require more prolonged use of sleep medicine. If your sleep problems continue, consult your doctor, who will determine whether other measures are needed to overcome your sleep problems.

Dependence

Sleep medicines can cause dependence in some people, especially when these medicines are used regularly for longer than a few weeks or at high doses. Dependence is the need to continue taking a medicine because stopping it is unpleasant.

When people develop dependence, stopping the medicine suddenly may cause unpleasant symptoms (see *Withdrawal* below). They may find they have to keep taking the medicine either at the prescribed dose or at increasing doses just to avoid withdrawal symptoms.

All people taking sleep medicines have some risk of becoming dependent on the medicine. However, people who have been dependent on alcohol or other drugs in the past may have a higher chance of becoming addicted to sleep medicines. This possibility must be considered before using these medicines for more than a few weeks. If you have been addicted to alcohol or drugs in the past, it is important to tell your doctor before starting LUNESTA or any sleep medicine.

Withdrawal

Withdrawal symptoms may occur when sleep medicines are stopped suddenly after being used daily for a long time. In some cases, these symptoms can occur even if the medicine has been used for only a week or two. In mild cases, withdrawal symptoms may include unpleasant feelings. In more severe cases, abdominal and muscle cramps, vomiting, sweating, shakiness, and, rarely, seizures may occur. These more severe withdrawal symptoms are very uncommon. Although withdrawal symptoms have not been observed in the relatively limited controlled trials experience with LUNESTA, there is, nevertheless, the risk of such events in association with the use of any sleep medicine.

Another problem that may occur when sleep medicines are stopped is known as "rebound insomnia." This means that a person may have more trouble sleeping the first few nights after the medicine is stopped than before starting the medicine. If you should experience rebound insomnia, do not get discouraged. This problem usually goes away on its own after 1 or 2 nights.

If you have been taking LUNESTA or any other sleep medicine for more than 1 or 2 weeks, do not stop taking it on your own. Always follow your doctor's directions.

Changes In Behavior And Thinking

Some people using sleep medicines have experienced unusual changes in their thinking and/or behavior. These effects are not common. However, they have included:

- More outgoing or aggressive behavior than normal
- Confusion
- Strange behavior
- Agitation
- Hallucinations
- Worsening of depression
- Suicidal thoughts

How often these effects occur depends on several factors, such as a person's general health, the use of other medicines, and which sleep medicine is being used. Clinical experience with LUNESTA suggests that it is rarely associated with these behavior changes.

It is also important to realize it is rarely clear whether these behavior changes are caused by the medicine, are caused by an illness, or have occurred on their own. In fact, sleep problems that do not improve may be due to illnesses that were present before the medicine was used. If you or your family notice any changes in your behavior, or if you have any unusual disturbing thoughts, call your doctor immediately.

Pregnancy And Breastfeeding

Sleep medicines may cause sedation or other potent effects in the unborn baby when used during the last wee of pregnancy. Be sure to tell your doctor if you are pregna if you are planning to become pregnant, or if you becor pregnant while taking LUNESTA.

In addition, a very small amount of LUNESTA may be prese in breast milk after use of the medication. The effects of ve small amounts of LUNESTA on an infant are not know therefore, as with all other prescription sleep medicines, it recommended that you not take LUNESTA if you are brea feeding a baby.

Safe Use Of Sleep Medicines

To ensure the safe and effective use of LUNESTA or any oth sleep medicine, you should observe the following cautior

1. LUNESTA is a prescription medicine and should used ONLY as directed by your doctor. Follow yo doctor's instructions about how to take, when to tak and how long to take LUNESTA.
2. Never use LUNESTA or any other sleep medicine t longer than directed by your doctor.
3. If you notice any unusual and/or disturbing though or behavior during treatment with LUNESTA or a other sleep medicine, contact your doctor.
4. Tell your doctor about any medicines you may taking, including medicines you may buy without prescription and herbal preparations. You should als tell your doctor if you drink alcohol. DO NOT use alcoh while taking LUNESTA or any other sleep medicine.
5. Do not take LUNESTA unless you are able to get 8 more hours of sleep before you must be active agai
6. Do not increase the prescribed dose of LUNESTA any other sleep medicine unless instructed by yo doctor.
7. When you first start taking LUNESTA or any oth sleep medicine, until you know whether the medicir will still have some effect on you the next day, us extreme care while doing anything that requir complete alertness, such as driving a car, operatir machinery, or piloting an aircraft.
8. Be aware that you may have more sleeping problem the first night or two after stopping any sleep medicin
9. Be sure to tell your doctor if you are pregnant, you are planning to become pregnant, if you becom pregnant, or if you are breastfeeding a baby whi taking LUNESTA.
10. As with all prescription medicines, never shar LUNESTA or any other sleep medicine with anyon else. Always store LUNESTA or any other sleep medicir in the original container and out of reach of children
11. Be sure to tell your doctor if you suffer from depressio
12. LUNESTA works very quickly. You should only tak LUNESTA immediately before going to bed.
13. For LUNESTA to work best, you should not take it wit or immediately after a high-fat, heavy meal.
14. Some people, such as older adults (i.e., ages 65 an over) and people with liver disease, should start wit the lower dose (1 mg) of LUNESTA. Your doctor ma choose to start therapy at 2 mg. In general, adult under age 65 should be treated with 2 or 3 mg.
15. Each tablet is a single dose; do not crush or brea the tablet.

Note: This summary provides important information abou LUNESTA. If you would like more information, ask you doctor or pharmacist to let you read the Prescribin Information and then discuss it with him or her.

Rx only

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EDITED BY LEE WALCZAK

A Revolt at The Schoolhouse Door

WITH ALL THE *Sturm und Drang* befitting a revolution, Newt Gingrich & Co. rolled into Washington in 1994 promising to take an ax to the federal bureaucracy. One of the top targets: the Education Dept., which conservatives saw as a bureaucratic monster encroaching on states' rights. Meanwhile, in Richmond, Va., a new Republican governor had his own idea about fixing schools—one that would require students to pass tough competency tests. After a public outcry, the Gingrichites beat a hasty retreat. But Governor George Allen's Standards of Learning program was enacted and became one of the first school-accountability programs in the nation.

Education reform is causing an outcry again, but this time state lawmakers are taking aim at the Bush Administration. In 2001, Hill Republicans, prodded by President Bush, opted for a top-down approach to school performance. Bush's No Child Left Behind Act (NCLB) took a page from Allen and applied it nationwide, imposing a rigorous testing regime on states and transforming the agency Gingrich tried to deep-six from a $14 billion backwater into a $22.4 billion behemoth.

It's not just Democrats who are throwing spitballs. Republicans, including now-Senator Allen, blast the law, citing rising costs and hopeless goals. Allen calls the program a "counterproductive federal intrusion" that hampers state reforms. Virginia, for example, already tests students in math and reading—as well as science, economics, and history—before graduation. NCLB "would require us to dumb down our standards to the federal level," Allen says. He and Representative Bob Goodlatte (R-Va.) have introduced legislation to let some states opt out of No Child directives.

ALLEN wants to avoid having to "dumb down" Virginia standards

The bill is symptomatic of a growing grassroots rebellion. With all states required to begin testing this year, and as sanctions against lagging schools begin to take effect, more than 20 states are debating whether to drop out and forgo federal funding. Others have simply set ridiculously low standards to make targets easier to meet.

The Administration points to the program's successes, especially rising test scores. "We've gotten assessment results from over half the states, and we're seeing higher math or reading scores in almost every one," Education Secretary Margaret Spellings said on Aug. 23.

But states aren't buying it. On Aug. 22, Connecticut Attorney General Richard Blumenthal—backed by his Republican governor, Jodi Rell—sued the federal government, accusing Washington of not ponying up enough money. Other states, such as Maine and New Jersey, are expected to follow suit.

The school revolt is being driven largely by Republicans. "If you go into the states, there are more Republicans opposed to [NCLB] than Democrats," says Neal McCluskey, an analyst at the libertarian Cato Institute. The rebellion is opening fissures in a GOP already agonizing over the Iraq war and runaway spending on Bush's watch. On one side are small-government Republicans who abhor Washington dictates. On the other are pols like Bush who want to use government's machinery to push conservative ideals—including shock treatment for failing public schools.

"NCLB, at the grassroots, has become one of a growing litany of frustrations" for Republican hardliners, says Michael Franc, a Heritage Foundation analyst. "They get the sense that conservatives in Washington have lost their competence." But as criticism mounts, Bush is hanging tough. The Reformer-in-Chief reckons that rising math and reading scores will soon silence his critics. ■

–By Lorraine Woellert

No Gripe Left Behind

States have been complaining about No Child Left Behind ever since Congress passed it in 2001. But now a full-fledged rebellion is building. Here are the states' biggest beefs:

FLEXIBILITY The law fails to recognize challenges faced by school districts with special student populations, such as the learning-disabled or non-English speakers. Forty states have requested exemptions from parts of the law, with varying degrees of success.

FUNDING Federal money accounts for less than 8% of all school funds, but NCLB has affected nearly all classroom activity. Many states have hired auditors to nail down the program's true cost. Connecticut's lawsuit calls the law an unfunded mandate.

TOO MUCH TESTING An excessive amount of class time is spent prepping students to pass NCLB's reading and math tests at the expense of other subjects such as history.

EFFICACY The program doesn't target the students who need the most help. Studies show, for example, that poorly performing students rarely take advantage of NCLB rules that allow them to transfer to better schools.

JAPAN

CANON: COMBAT-READY

Cost cutting and lavish R&D spending have made it strong. But maintaining profit growth won't be easy

THE GIANT STATUE OF Buddha that overlooks Canon Inc.'s Ami plant in Ibaraki, north of Tokyo, is hard to miss. Standing 394 feet tall—higher than the Statue of Liberty—the Buddha watches over a landscape of verdant fields and the occasional factory. For workers assembling photocopiers in the Canon facility, though, Buddha's stare pales in comparison to Hiroshi Ishii's steely gaze. Plant manager Ishii likes nothing more than to scour the factory for any hint of inefficiency. "No matter how small, we have to identify waste and find ways to eliminate it," he says, casting a knowing eye over a young worker wrapping copying machines in plastic.

Ishii may sound obsessive, but it's that sort of passion for improvement that has transformed Canon from a symbol of debt-ridden, post-bubble Japan into one of the country's leading enterprises. Ishii and his colleagues at Ami, for instance, have developed systems such as foot-controlled motors that rotate workstations so workers don't have to step around the copiers they're assembling. And since extending one's arm takes time, Canon is shaving seconds by striving to put all components and tools within 8 inches of a worker's hand.

Driving Canon's quest for efficiency has been CEO Fujio Mitarai, who stepped into the top job a decade ago. When he took over, Mitarai was dismayed by the debts of $7.5 billion he inherited. Worse, perhaps, was Canon's mishmash of businesses, ranging from liquid crystal displays to typewriters. So, going against years of Canon tradition, he became one of Japan's leading cost cutters. Mitarai focused only on the profitable products—mainly copiers, printers, and cameras—and dumped seven departments, including the personal computer, typewriter, and LCD screen divisions. In the past five years, savings have averaged $800 million annually, even as sales have jumped by 30%.

"STEADY PROGRESS"

MITARAI'S FIXATION on cost cutting and financial prudence—picked up during 23 years at Canon's U.S. operations—has paid off in profits. On July 27, Canon announced that its operating margin for the first half was 15.4%—about double that of most printer-and-copier rivals and triple that of leading consumer electronics ma ers. For the year, Canon expects earning to grow by 6.9%, to $3.28 billion, on sal of $32.9 billion, up 6.1% from 2004.

That's not to say Canon has no worrie Its digital camera business, while more r silient than many rival operations, is ur likely to repeat the profit growth of the la five years as camera prices tumble. JPMo gan Chase & Co. projects that margins the camera division will fall to 12.2% b 2009, from 17% today. Meanwhile, despit better-than-expected sales, Canon's se ond-quarter operating profit fell short expectations because of the declinin prices. In response, Canon's stock ha tumbled by 8% since July 20. "This show that even Canon isn't immune to pric pressure," says John Yang, an equ ty analyst at Standard & Poor's i Tokyo who cut his Canon ratin from "buy" to "hold" after the mos recent results.

Another concern is the emer gence of new competitors i Canon's mainstay business-ma chine segment, the printers an copiers that make up 65% of sales Chinese manufacturers might in crease exports of replacement tone cartridges—which represent th bulk of profits for virtually all print er makers. Hewlett-Packard Co. meanwhile, is both a partner an rival to Canon, buying the guts o its laser printers from the Japanes company but pushing hard t boost sales of its own ink-jet mod els. And Dell Inc. last year sold $ billion worth of printers and ha nabbed 13.3% (in units) of the U.S market for color laser printers sinc jumping into the fray just over tw years ago.

A greater potential issue for in vestors is the retirement o

Canon's Challenges

What Mitarai must do to stay ahead

COST CUTTING
Facing world-class competitors such as Sony, Matsushita, and Dell, Canon needs to find still more savings by increasing automation, boosting in-house production, and winnowing suppliers.

TUNE IN TO TV
Canon hopes to sell 250,000 newfangled SED flat-screen TVs a month by 2010, but first it will need to bring down manufacturing costs and build a brand in a sector where it has no experience.

COLOR CRUSADE
To keep prospering, Canon needs to speed the shift to color office equipment worldwide. In Japan, more than a quarter of all copiers bought by companies are color, but the U.S. and Europe lag behind.

MORE SUPERSTAR PRODUCTS
With digital camera sales growing more slowly, investors want to see new products to keep profits rolling in over the next five years.

Canon PowerShot SD30

Data: Citigroup, Gartner Dataquest

THE BOSS Mitarai is fixated on efficiency and financial prudence

Canon's dynamic, 69-year-old boss. No hand-off plan has been publicly discussed, and the company declines to comment on potential successors. "I'm very concerned what happens after Mr. Mitarai," says Hisashi Moriyama, an analyst at JPMorgan Chase in Tokyo. Despite his age, though, Mitarai doesn't sound like someone with one eye on the exit door. "I won't say in how many years I will quit. I don't think about it that way," he says. "I set myself a goal and make sure I achieve it."

The goal now is profits, and Mitarai says Canon's current run in that department is far from over. The company is the world's No.1 digital camera maker, with 23.6% of the global market, just ahead of Sony Corp.'s 23.2%. Despite the slowdown in digital camera sales growth, Canon's offerings are still delivering healthy earnings at a time when some big rivals are losing money. And Canon is likely to ride the transition from monochrome printers and copiers to more profitable color models for the rest of this decade.

> "Even Canon isn't immune to price pressure"

Some analysts fret that the company may not be able to come up with the kind of new products necessary to keep growing and achieving double-digit margins, but Mitarai is devoting piles of yen to research. This year, Canon will spend 8% of sales on research and development, compared with 6% to 7.5% at many large rivals. Over the years that has paid off in lots of ideas: Canon has filed more than 17,000 patents in the U.S. since 1995—second only to IBM. Most of Canon's products rely on patented core technologies developed in-house, such as photosensitive drums in laser printers or imaging engines used in digital cameras. "We have to plant the seeds for the next decade and beyond," says Mitarai.

MORE ROBOTS

SOME OF THOSE SEEDS, Canon hopes, will grow into three video display technologies: SED TV panels, which are a new kind of flat-screen television that Canon plans to build with Toshiba; rear-projection TVs; and OLEDs (short for organic light-emitting displays). Canon has announced plans to begin selling the SED TVs next year, but skeptics say it may be tough to bring down costs fast enough to seriously challenge other flat-screen technologies. OLEDs, meanwhile, use less power and are brighter than LCDs. Starting in 2007, Canon hopes to begin swapping them for some of the 20 million small LCD screens it currently buys annually for use in its printers, cameras, and camcorders.

Canon isn't finished with its cost cutting, either. Last year the company announced plans to trim an additional 10%, or $1.1 billion, from procurement costs by 2006. And executives expect more savings from increased automation. "We have to start thinking of a new production method that will be more efficient," says Mitarai, who aims to triple the number of robots used at Canon by 2008. Attention to detail. Relentless cost cutting. Lavish spending on research. It's a formula that has served Canon well. ■

–By Ian Rowley, with Hiroko Tashiro, in Tokyo, and Louise Lee in San Mateo

JAPAN

'AN ENVIRONMENTAL TIME BOMB'

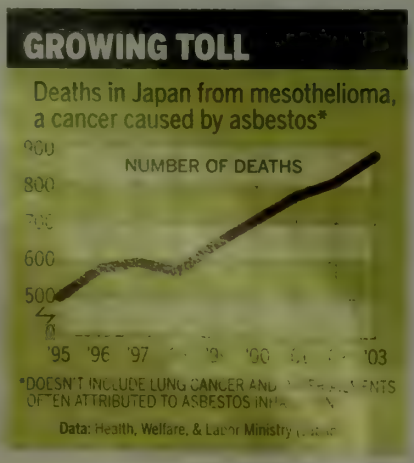
Tokyo ignored asbestos for years. Now it's paying the price

FOR DECADES ASBESTOS has been known to cause cancer in those who inhale its tiny fibers. That has triggered restrictions on its use and, ultimately, thousands of lawsuits in the U.S. and elsewhere. But in Japan, asbestos barely cracked the headlines over the years, let alone the court system. It was only last October that Tokyo finally banned asbestos in all but a handful of products—14 years after similar action in the U.S. Even then the government implemented no measures to prevent asbestos—once widely used as fire-retardant insulation—from being released into the air as older buildings were renovated or torn down.

Today the carcinogen is suddenly big news from Kyushu to Hokkaido. On June 29, farm machinery maker Kubota Corp. acknowledged, in response to inquiries from the daily *Mainichi Shimbun*, that since 1978, 79 of its workers had died after inhaling asbestos fibers. Within days dozens of companies reported previously undisclosed fatalities blamed on asbestos. Now the government is scrambling to explain why it paid scant attention to the issue for so long. "We should have banned asbestos sooner," Health, Labor, & Welfare Minister Hidehisa Otsuji told a parliamentary committee on Aug. 3.

Some of Japan Inc.'s biggest names are grappling with the problem. Workers at top steelmaker JFE Holdings were exposed to asbestos in insulation until the company stopped using it in the 1970s. Taiheiyo Cement Corp., Japan's leading cement producer, made asbestos tiles and insulation. Sumitomo Heavy Industries and Mitsubishi Heavy Industries installed asbestos insulation in ships. "Asbestos is still around in so many forms, it's like an environmental time bomb waiting to go off," says Hirotada Hirose, a Tokyo Women's Christian University professor.

TOO LITTLE, TOO LATE? Cleaning up a grade school



The government has tried to calm an uneasy public. In recent weeks it has set up phone banks to field calls from citizens worried about asbestos exposure and toughened regulations on demolishing buildings. The government estimates that 6,060 people died of mesothelioma—a cancer caused by asbestos—from 1995 to 2003. That's a fraction of the 200,000-plus deaths in the U.S. that have been blamed on asbestos over the past 40 years, but Japan's statistics are incomplete because it only began keeping track in 1995 as the toll mounted. Given the country's tardy response to the problem, the number may continue to climb for decades to come, since asbestos fibers can remain in the body for 40 years before developing into cancer.

With a parliamentary election in September, it could be months before lawmakers debate compensation for those exposed to asbestos. After revealing its asbestos problem, Kubota acknowledged that it had paid "condolence money" of up to $270,000 to the families of dozens of workers. Kubota says its prompt action after halting asbestos production in 2001 may help it avoid lawsuits. Other corporations say they followed Kubota's lead to avoid the appearance of a coverup. Nonetheless, "companies should be held responsible for paying some of the damages to victims," says Satomi Ushijima, who chairs a Tokyo Bar Assn. committee on asbestos.

So far, Japan's track record on compensation isn't terrific. Japanese culture shuns the notion of legal redress through the courts, and class actions are banned, so only a handful of asbestos-related cases have been brought. On Aug. 3, the Supreme Court threw out a lawsuit by the wife of a man who died of mesothelioma but whose only traceable link to asbestos had been his father, a factory worker. And just 848 people with mesothelioma or asbestos-related lung cancer have applied for free medical treatment under workers' compensation. The country is finally catching up with the rest of the world on asbestos removal. Now it must care for those who have already been exposed. ■

–By Kenji Hall in Tokyo

BARCELONA ACS staffers hail from 38 countries

SPAIN

CAFES, BEACHES, AND CALL CENTERS

Fair-weather Spain is the new European hot spot for outsourcing

THE 2002 HIT FRENCH movie *L'Auberge Espagnole* captured the zeitgeist of Barcelona. In the film, a group of college students from all over Europe shares an apartment (and occasionally each others' beds) and bond over beer and music. But it's all a bit of a fantasy. In the real Barcelona, those kids would more likely be working at one of the many call centers springing up around the city.

After a slow start, Europe is finally jumping on the outsourcing bandwagon. Consultancy TPI of Woodlands, Tex., figures that European companies awarded $41 billion in outsourcing contracts in 2004, nearly twice the level of two years earlier. One of the hottest destinations for the work is Spain, where thousands of young Europeans flock every year in search of sun and sangria—and jobs. Already some 50,000 people from all over Europe work in more than 2,000 Spanish call centers and so-called shared service centers, which handle functions such as tech support, accounting, and personnel administration. London-based Datamonitor PLC says the industry will add 30,000 jobs in the next two years.

Spain's appeal is easy to fathom. Wages for service-center workers are about 30% lower than in northern Europe. But that's not the only reason multinationals such as Avis, Hewlett-Packard, Nestlé, and Citigroup have set up shop there. In a business where employee turnover is a big problem, quality of life makes a crucial difference in attracting and retaining talent. "Instead of sitting in ten inches of snow in Poland, wouldn't you rather be sitting in ten inches of warm sand in Barcelona?" asks Stephen A. Koutros, a partner at TPI.

Other locales, such as India and Eastern Europe, are also grabbing big call-center business. But Spain retains some potent advantages, especially for European companies looking to "nearshore" work close to home. Because it's part of the European Union, people from anywhere in the EU can work there without visas or permits. And Spanish facilities can handle sensitive banking and medical transactions that aren't allowed to be sent outside the EU.

WAGE PROBLEMS?

THAT'S ONE REASON Dallas-based Affiliated Computer Services Inc. (ACS) set up shop in Barcelona three years ago. The $5-billion-a-year company, which specializes in tech support and back-office outsourcing, has nearly 500 employees there. They hail from 38 countries and speak 14 languages. Most of them provide service to General Motors Europe. One group of 300 handles finance functions, including $50 billion a year in accounts payable. The remaining 150 administer GM's European human resources, fielding calls from the company's European workers and retirees who have questions about benefits or paychecks.

For all its allure, Spain must contend with wages that have climbed 36% for the country as a whole since 1998. That's what hurt growth in the Irish service-center industry. Yet Spain's outsourcing trend shows no sign of letting up. French information-technology services outfit Teamlog is expanding its 120-person European help center for Hewlett-Packard outside Barcelona. Eric Lemeilleur, who runs the operation, concedes with a laugh that "most employees here know *L'Auberge Espagnole* by heart." All that beer and free love are paying off for Spain's economy. ■

–By Andy Reinhardt in Barcelona, with Carlta Vitzthum in Madrid

Follow the Sun

Companies are flocking to Barcelona to set up back-office and call-center operations. A sampling:

CITIGROUP has 1,200 employees handling customer support and internal services for Western Europe

GENERAL MOTORS has outsourced its European accounting, financial services, and HR support to 450 employees of U.S.-based IT services company ACS

HEWLETT-PACKARD handles internal and some external tech support using 120 staffers from French IT services outfit Teamlog

AGILENT TECHNOLOGIES runs administration, finance, and customer service for Europe, the Mideast, and South America using 600 staffers

Data: Company reports, Trade Commission of Spain

EDITED BY DAVID ROCKS

China and India: A Rage for Oil

AMERICAN ATTENTION has lately been focused on China's emergence as a competitor for dwindling oil supplies—witness the uproar over CNOOC Ltd.'s failed bid for California's Unocal Corp. But a different, yet equally intense, energy rivalry sure to have a dramatic effect on geopolitics has been playing out on the far side of the globe. Asia's other emerging powerhouse, India, is just as hungry for supplies as China. The two are battling each other in oil patches from Sudan to Siberia as they try to secure the resources to fuel their growing economies. So far, the Chinese have the upper hand in the competition.

The latest skirmish came on Aug. 22, when the board of PetroKazakhstan Inc., a Canadian-owned company with oil fields in Central Asia, accepted a $4.2 billion takeover bid by state-owned China National Petroleum Corp. CNPC beat a $3.6 billion offer from India's own state-owned giant, Oil & Natural Gas Corp. ONGC has said it may make a counteroffer, but the competition has already pushed the price into the stratosphere. CNPC's bid was a 21.1% premium on the price of PetroKazakhstan's shares. And it values the company's proven reserves at $10.26 per barrel—20% more than the market valuation of CNPC's own reserves, according to United Financial Group, a Moscow investment bank.

RICH PRIZE
A Chinese major will take over Canada-owned PetroKazakhstan

The upper hand

BOTH OF ASIA'S rising powers desperately need energy. China today imports roughly half its oil. Consumption rose by 15% last year and is forecast to jump by an additional 9% this year. By 2025, China will burn through 14.2 million barrels a day, double this year's level, the U.S. Energy Dept. predicts. India's oil imports are expected to rise to some 5 million barrels a day by 2020, from around 1.4 million barrels at present.

The Chinese are gaining ground in Russia. Last December both New Delhi and Beijing negotiated with Moscow as it sought financing for its $9 billion renationalization of Yuganskneftegaz, the core production subsidiary of the troubled oil major Yukos. Although neither Asian rival walked away with equity in the Russian company, the Chinese ended up lending the Russians $6 billion in return for guaranteed oil supplies at a bargain price. And in Angola last year, China Petrochemical Corp. (better known as SINOPEC) beat ONGC in bidding for an oil exploration block being sold by Shell Oil Co.

Beijing has the upper hand now. But Moscow is old friends with Delhi

That's largely because China has greater financial muscle. In the past five years, CNPC has invested $45 billion in new energy sources, compared w ONGC's $3.5 billion. Another proble some grumble, is India's democrati and therefore slow—political syste which may make it harder for ONGC jump at investment opportunit abroad. "Whenever we've seen the In ans and Chinese tussle, the Chinese ha been faster and more aggressive in taining their objective," says Steph O'Sullivan, head of research at Unit Financial Group.

Feelings of mistrust

BUT DON'T COUNT India out yet. T country's hopes of international expansi are being kindled by Delhi's energetic troleum & Natural Gas Minister, Ma Shankar Aiyar. And despite China's de with Russia after the compe tion for Yuganskneftegaz, Inc holds some strong cards wi regard to Russia, which is ra idly emerging as a key sour for Asia's energy need Moscow has a friendship wi Delhi that dates to the Co War—while the Kremlin h long viewed Beijing with mi trust. India and Russia ha been busy bolstering their e tensive military and scienti ties, most recently throug Delhi's Aug. 16 purchase of 2 Russian engines for use in new Indian military jet traine India has already investe $1.7 billion in Sakhalin-1, major oil-and-gas field o Russia's Pacific coast, and re cently committed an add tional $3 billion for inves ments in other projects.

China, meanwhile, i emerging as a player in Central Asi Beijing has signaled its support for th region's authoritarian leaders, who fac criticism in the West and the threat o unrest at home. And Kazakhstan has strong economic incentive to look t China, the closest and most obvious ma jor market for its oil. PetroKazakhsta has proven reserves of 535 million bar rels and produces 150,000 barrels a da Much of that will probably be processe at Chinese refineries following the com pletion of a pipeline between the tw countries.

As the global economic balance shift toward Asia in the decades ahead, China and India may well cooperate in man spheres. Energy, clearly, will not b among them. ■

–By Jason Bush in Moscow

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Insuring the global economy:

the Bermuda model

It seems faintly absurd. How can Bermuda, an island the size of Manhattan, with just 65,000 people, have a consistently more vibrant insurance industry than the U.S. or London, the other market leaders?

The answer is complex. In small part, as with any successful enterprise, it is luck. Bermuda is undeniably an attractive place to do business, or anything else. A location at the geographical and temporal crossroads of North and South America and Europe could hardly be more perfect. But much more than luck is at work: the basis on which Bermuda has built its insurance industry is a mix of factors that has become known as the "Bermuda Model," much imitated but never equaled.

Five centuries of island life have bred entrepreneurial spirit deep into the bone. Having the Western Hemisphere's second-oldest government – Bermuda's Parliament first sat in 1620 – has provided the stability on which to build successive industries of agriculture, hospitality, and now financial services.

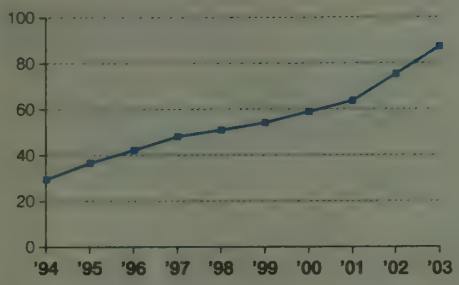
Waves of insurance

Bermuda's insurance market was founded in 1947, when American International Group established an office in Hamilton, the capital. Within 10 years, the company employed 300 people on "the Island."

In the mid-1960s, Fred Reiss, an Ohio businessman, established his first captive insurance company. After consulting with professional advisors, he chose Bermuda. Captives are vehicles for insuring parent companies, or groups of like-minded businesses, and retaining the profit. →

"Bermuda's insurance sector is a highly focused group of people operating in a relatively small city. That facilitates contact and communication."

Scott Carmilani, president and CEO, Allied World Assurance Holdings, Ltd

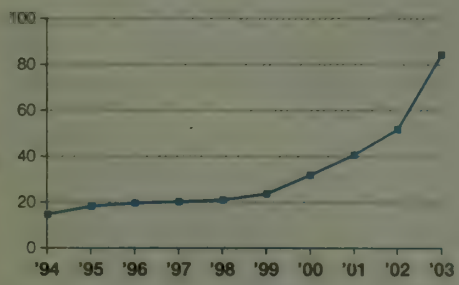


Bermuda – International Insurers' Capital & Surplus
(U.S. $ billions)
Source: Bermuda Monetary Authority

Captive Insurance Companies
As of December 31, 2004

Jurisdiction	Percent of global captives
Bermuda	37
Cayman Islands	12
Guernsey	12
U.S.	11
Other non-U.S. Western hemisphere	11
Ireland	9
Other Europe and Asia	8

Source: KPMG



Bermuda — Net written premiums
(U.S. $ billions)
Source: Bermuda Monetary Authority

Self-insurance, now a global practice that Bermuda continues to dominate, is one of a suite of disciplines known as "alternative risk financing." Half of all North American property/casualty insurance now falls under this rubric.

Bermuda's response to three global shortages of insurance capacity in the past 20 years has made the Island what it is today. On each occasion, traditional insurance markets could not cope with a particular stress. On each occasion, Bermuda coped. As a result, it is now an integral plank in the global insurance structure, complementary to, rather than an enemy of, existing markets.

In the mid-1980s, large U.S. corporations were finding excess liability insurance almost impossible to come by. In response, brokers Marsh & McLennan organized two new companies, ACE and XL Capital, whose shareholders were the very U.S. corporations that needed coverage. ACE and XL Capital quickly established themselves in Bermuda and thrived, reporting combined capital at June 30, 2005, of $18.8 billion.

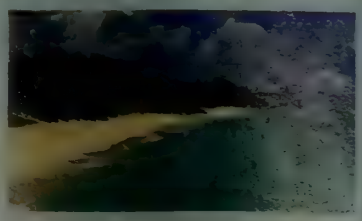
In August 1992, Hurricane Andrew slammed into the Florida coast, inflicting damage costing more than $20 billion, in today's dollars. The loss chilled the world's catastrophe reinsurance markets, and coverage evaporated worldwide. Eight companies were formed in Bermuda by the following summer, sporting $4 billion in capital, to ease the shortage. It was a watershed, the moment at which Bermuda's importance as a cornerstone of the global insurance market became incontrovertible.

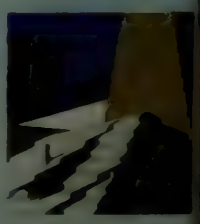
Then came Sept. 11, 2001. The destruction of the World Trade Center froze the world's insurance companies as they assessed their share of the $40 billion cost.

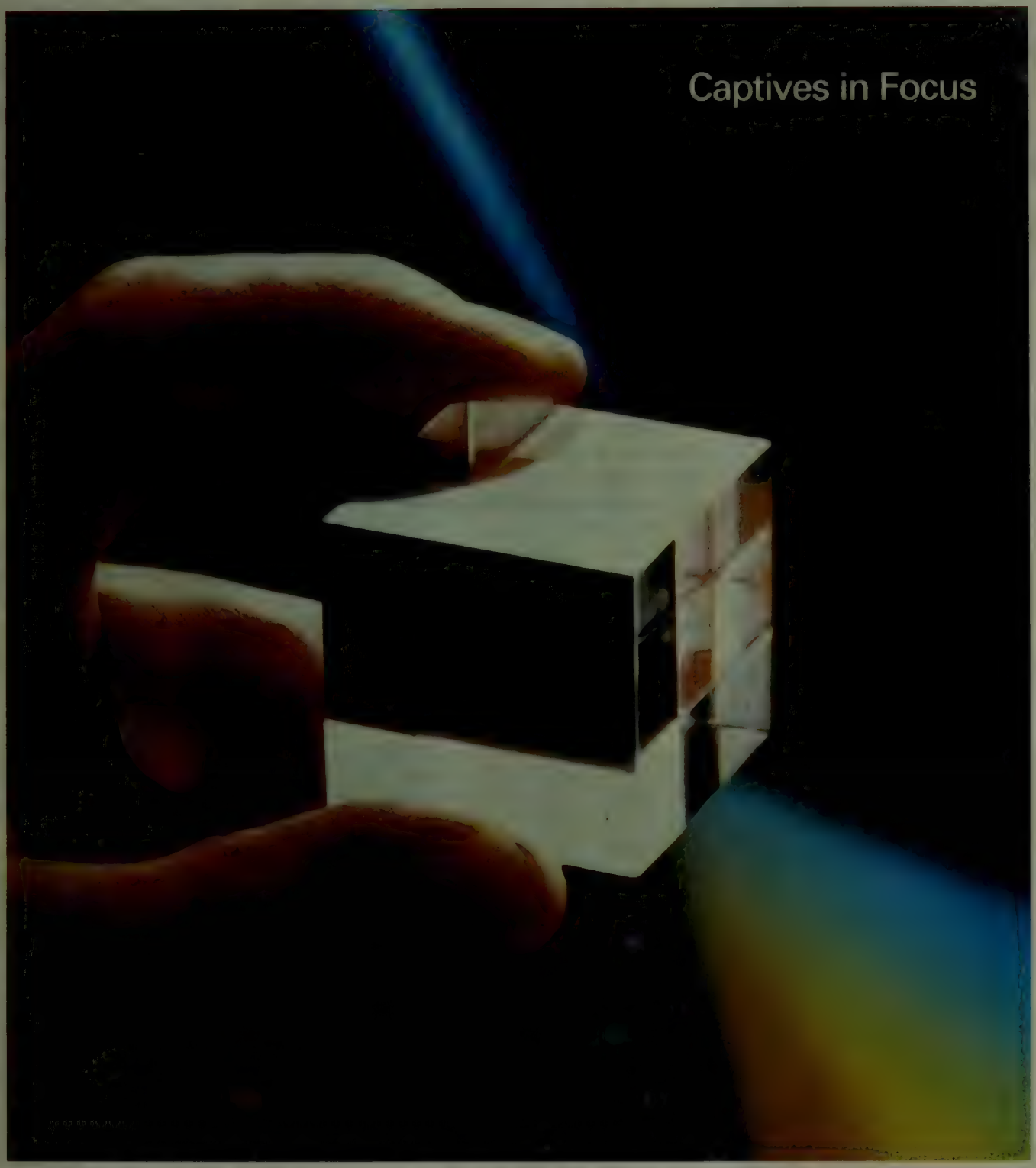
Capital abhors a vacuum. Its response was the largest, fastest deployment of resources in history: more capital, raised more quickly (in constant dollars), than the Marshall Plan or the Moon Shot. The insurance industry added $25 billion in the months following 9/11, two thirds of which went to Bermuda.

Another advantage Bermuda's dynamic and compact marketplace offers new companies is the opportunity to start business almost as soon as their doors are open. In 2004, in just their third year of operations, the eight major Bermuda insurers and reinsurers formed in response to 9/11 earned among them premium income of $9.5 billion.

Allied World Assurance Holdings was one of the eight companies. It has prospered in the intervening years. "We chose Bermuda because, although the scrutiny was rigorous, we were able to incorporate quickly, at a time when demand for capacity was at a very high level," says president and CEO Scott Carmilani. "Bermuda has proved to be the right choice for us. Our customers tell us they are very comfortable with our being here."







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"Bermuda is renowned for its intellectual capital, has proven to be open to innovation, and has pioneered a number of important insurance techniques."

Robert Cooney, chairman, president, and CEO, Max Re Ltd.

Hon. W Alexander Scott,
J.P., M.P,. Premier of Bermuda

Bermuda Government: Taking the Global View

Bermuda's unique blend of insurance, reinsurance, investment, trusts, and global banking capacity are all located in one of the top tourism centers in the world.

"Bermuda is therefore a must in the portfolio of global corporate chief executives seeking the best financial services and platform," says the Hon. W. Alexander Scott, J.P., M.P., Premier of Bermuda (pictured above).

Since coming to power in 1998, the Progressive Labour Party Government has consolidated Bermuda's solid reputation by taking steps that have led to the continued buoyancy of the international business sector of the economy.

Government judged early in 2005 that the economy had performed well in 2004. This was affirmed by Moody's Investors Service's recently released 2004 report on Bermuda's economy, which indicated that Bermuda's government finance indicators were vastly better than those of its peers in the broad Aaa-A3 rating.

"The Ministry of Finance is very active in protecting the national economic interest," says the Hon. Paula A. Cox, J.P., M.P., Minister of Finance. "After having been among the first international financial centers to sign a U.S. Tax Convention in 1986 and a Taxation Information Exchange Agreement (TIEA) with the U.S. in 1988, we are negotiating TIEAs with OECD countries such as Australia, New Zealand, Germany, The Netherlands, and Mexico."

Those in the know come to Bermuda.

Bermuda Government: www.gov.bm
The Registrar of Companies: www.roc.gov.bm
The Bermuda Monetary Authority: www.bma.bm

In the past decade, the Bermuda market has added breadth and depth, offering new lines of business and opening subsidiaries around the world. New companies, new ideas, and new approaches have consistently been the order of the day, an insurance version of the technology sector's experience in Silicon Valley.

For example, insurers traditionally focused on managing their liabilities for claims but are now concentrating equal attention on managing the asset side of the balance sheet. The traditional philosophy of investing in fixed-income instruments has been augmented with investments in equities and, lately, hedge funds. An early adopter of the latter strategy was Max Re Capital, which was formed in Bermuda in 1999.

"Max Re differentiates itself by applying an intensely analytical approach to both underwriting and investment risk assumption," says Max Re's chairman, president, and CEO, Robert Cooney. "While we focus on traditional classes of insurance and reinsurance, we believe our sophisticated investment strategy, which includes exposure to alternative investments, provides the opportunity for superior risk-adjusted returns."

What appealed to so many companies in the past was Bermuda's meaningful but intelligent level of regulation and its fast response time. Today, those advantages remain in place, but Bermuda has become an intense and highly focused insurance market, where business is carried out with great efficiency.

Continual growth; innovation; a reputation for probity and excellence; a market and world leader – what's the secret?

Teamwork makes it happen

In most places, government and business are perceived to be at odds. In Bermuda, each pursues its own agenda, but with a common goal. Maintaining Bermuda's integrity via firm but sensible regulation is in everyone's interest, an approach endorsed by the Organisation for Economic Cooperation and Development (OECD) and, just this year, the International Monetary Fund.

"Government's relationship with the international business sector is one of the keys to Bermuda's success as an international business center," says the Hon. W. Alexander Scott, Premier of Bermuda. "The strength of Bermuda as an international business hub is a consequence of having a government that sees itself as the leader in creating the best international-business regulatory infrastructure. We start from the point of view that cooperation, consultation, and cohesion are the tools of the trade."

That relationship is expressed via a network of committees, including those through which government seeks the insurance industry's input. There is no

"Bank of Bermuda is now uniquely placed as the only truly global bank with strong investment banking capabilities to deliver client solutions...."

Philip Butterfield, president and CEO, The Bank of Bermuda Limited

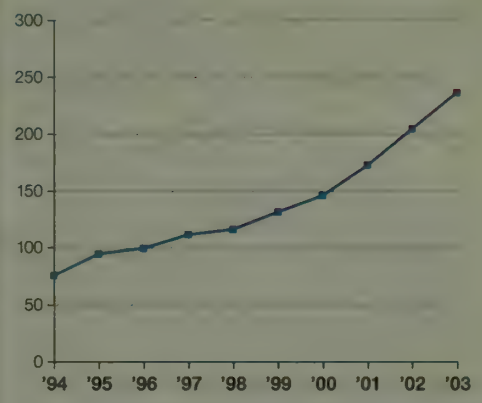
doubt that government is in charge, but it governs in an informed and sensible fashion, with a minimum of red tape. Why that idea has not caught on worldwide is an enduring mystery.

"As a leading, well-regarded, blue-chip international financial center, Bermuda is never complacent, and we are always looking to better position and enhance our status," says the Hon. Paula A. Cox, Minister of Finance. "Bermuda wants your business, including your insurance, reinsurance, investment, fund, and trust business."

A strong tradition

Bermuda has always limited its banking sector to better protect its reputation, and even now has just four commercial banks. The largest is the Bank of Bermuda, and the oldest, Butterfield Bank, was established in 1858, at about the time Abraham Lincoln was being nominated for the Senate.

Bank of Bermuda was acquired in 2004 by HSBC. "We're known for the strength of our client relationships and therefore understand that our major commercial customers are global organizations with global requirements for banking, custody, →



Bermuda – International Insurers' Assets
(U.S. $ billions)
Source: Bermuda Monetary Authority

TALENT EXPANDS POSSIBILITIES

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At Max Re, we've recruited some extraordinary talent to drive our business. From offices in Bermuda and Ireland, we underwrite a wide range of reinsurance and insurance transactions. Traditional Property and Casualty. ART solutions. Life and Annuity. Expanding the possibilities with innovative risk control, focused expertise and new approaches to established convention.

PROPERTY/CASUALTY INSURANCE & REINSURANCE LIFE/ANNUITY

AM Best's A- (Excellent) Fitch A (Strong)

"Bermuda's defining identity as a center of innovation, creativity, and substantial intellectual capital, combined with the Island's flexible regulatory environment, continue to fuel its impressive growth."

Laline Carvalho, director, Standard & Poor's Insurance Ratings

Alan Thompson, President and CEO, Butterfield Bank

Butterfield Bank: Progressing Through Service Strength

As the oldest bank in Bermuda, Butterfield Bank has been a cornerstone of the financial services industry on the Island since it was established in 1858. Offering full banking, wealth management, and trust and fund administration services in Bermuda, the Butterfield Bank Group also has operations in The Bahamas, Barbados, the Cayman Islands, Guernsey, and the United Kingdom.

"The Group has grown consistently over many years through the strategic development of our core businesses, both organically and through acquisitions," notes President and Chief Executive Officer Alan Thompson (pictured above). "The success of our strategy, however, rests on the strong customer service ethic of our organization. Truly excellent customer service touches every part of how you run your organization, from the professionalism and care of your employees to product innovation, technology, and premises."

Between 2002 and 2004, the Group increased net income by more than 35% (excluding a $17 million gain on the sale of subsidiaries in 2002), total assets by more than 40%, assets under administration by more than 73%, and shareholder value by more than 70%.

and a range of other services," says president and CEO Philip Butterfield. "HSBC is the second-largest bank in the world, by market valuation. Bank of Bermuda is now uniquely placed as the only truly global bank with strong investment banking capabilities to deliver client solutions and participate in a meaningful way in syndicated credit facilities."

Butterfield Bank serves a similar clientele with a similar philosophy, but a different approach. It has subsidiary operations in The Bahamas, Barbados, the Cayman Islands, the United Kingdom, and Guernsey. "We support our customers with operations in those centers where our service-oriented strategy is a competitive edge," says president and CEO Alan Thompson. "Our focus on developing our core businesses enables us to excel in our niche markets, whether in community banking, wealth management, fund administration, asset management, or trust. These are growing markets with a common appreciation of the need for responsive service."

A climate for business

"Bermuda has been 'in the business of international business' for close to 50 years," says Deborah Middleton, CEO of the Bermuda International Business Assn., an umbrella body that for more than 30 years has represented the accounting and legal professions, banks, trust companies, and telecommunications companies in Bermuda. "The infrastructure, in terms of intellectual capital and technological, legal, and regulatory systems, is a strong contributor to the continued growth of Bermuda's international business, including its insurance sector."

One of Bermuda's law firms this year elected to its partnership the grandson of one of the partners who founded the firm in 1927. The major global accounting practices have been in Bermuda since the early 1950s.

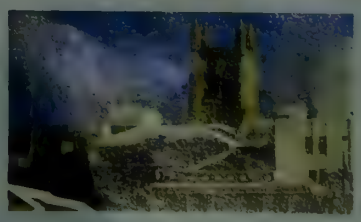
Separately represented, Bermuda's insurance brokers and those who manage smaller insurance companies have also been on the Island for decades.

Bermuda's size also works in its favor. Hamilton is probably the only city in the world where insurance is the main, and sometimes only, topic of conversation in restaurants and bars. Brokers and clients may well be able to visit more insurance offices in a day in Hamilton than they could in a week in New York, with a lot less legwork. Just about every household name in insurance has a presence in Bermuda, as do the majority of the largest U.S., European, and South American corporations, many of whom have operated Bermuda captives for decades.

Bermudians are well-educated, friendly, and willing to learn. Bermuda's tax neutrality allows companies to accumulate earnings in the jurisdictions that suit them best. Telecommunications in the "Wired Island" are superb. Bermuda applies relatively few

Butterfield Bank

For more information visit: www.butterfieldbank.com



"Government's relationship with the international business sector is one of the keys to Bermuda's success as an international business center."

The Hon. W. Alexander Scott, J.P., M.P., Premier of Bermuda

restrictions on how its companies, being sophisticated investors, may invest their assets and move capital on and off the Island. The Bermuda Stock Exchange is the world's first totally electronic bourse. The Island is just two hours by air from the East Coast and seven from London. It has first-class hotels, intimate guesthouses, and nine golf courses. What more could business ask for?

In short, says Robert DeRose, assistant vice president at A.M. Best: "Bermuda's growth and enhanced insurance market position are the result of the Island's now legendary operating platform, which enables Bermuda companies to set up shop quickly and allows them to operate with substantial competitive advantages over competitors in the United States and Europe." ■

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CONGDON AND BARON They mock everything from tech to pop culture

Rocketboom's Powerful Lift-Off

The news spoof is a model for video blogs —and may transform the way TV is viewed

AS THE VIDEO OPENS, the young woman zips in from the left side of the screen, rolling her chair into place, behind a laminated desk and in front of a world map. "I'm Amanda Congdon, and this is Rocketboom," says the blonde with a big grin, explaining that today's show will be an experiment in rapid-fire dispatches. With that, she shoots out of the screen to the right, reappearing from the left seconds later to report that *American Idol* fans cast 41 million votes by cell phone during the show's contest. "Damn," she deadpans. "That's more than voted for the President." She pauses, tips her head. "Well, maybe not." Then, zap, Congdon is yanked off the set once again and reappears to report on an iPod vending machine. Congdon rounds out the show with a spoof of a weather station pushing a "supercalifragilisticexpialidoppler" machine and a report on a $5.50 lock for Ben & Jerry's ice cream.

RUSSIA Congdon gives the audience a whimsical taste of what she did on her summer vacation

Don't bother looking for Congdon on your cable channel lineup. Rocketboom is a video blog, posted at rocketboom.com, and in 10 months it has become the most popular site of its kind on the Net. The brainchild of former musician Andrew Michael Baron, who writes the shows with Congdon, the three-minute mock news program covers everything from tech trends to pop culture with frank irreverence, sly humor, and a big dollop of unabashed silliness.

The approach is resonating with viewers. Daily downloads have doubled in the past six weeks, to 50,000. If they stay on that pace, they'll soon approach the 200,000 viewers of an established cable show, such as CNBC's Kudlow & Cramer. "There was this excitement early on that we videobloggers were at the forefront of something, but we didn't know what would happen," says Baron.

These are the early days of video blogging. Most of the postings on the Web are rough and tedious—little more than home movies. But the success of Rocketboom and a few sites like it underscore the potential of video blogs. Cheaper video recorders mean just about anyone can make videos, while the spread of speedy Net service means almost anybody can watch clips posted online. The result? The Internet is coming alive with a mix of video, from the polished parody of Rocketboom to the raw interviews of reporters. As these videos flow into the living room, they will reshape what we think of as television. "TV will be transformed," says Mitchell Kapor, the founder of Lotus Development Corp. and now an investor in Participatory Culture, an online video startup. "People will look at it as historically quaint that you had to watch something that others chose for you."

Congdon and Baron have no doubt their quirky show is the future. So while Rocketboom shows are lighthearted, the two are dead seri-

ANCHOR DESK Reading the news and talking to ex-Vice-Presidential candidate Senator John Edwards

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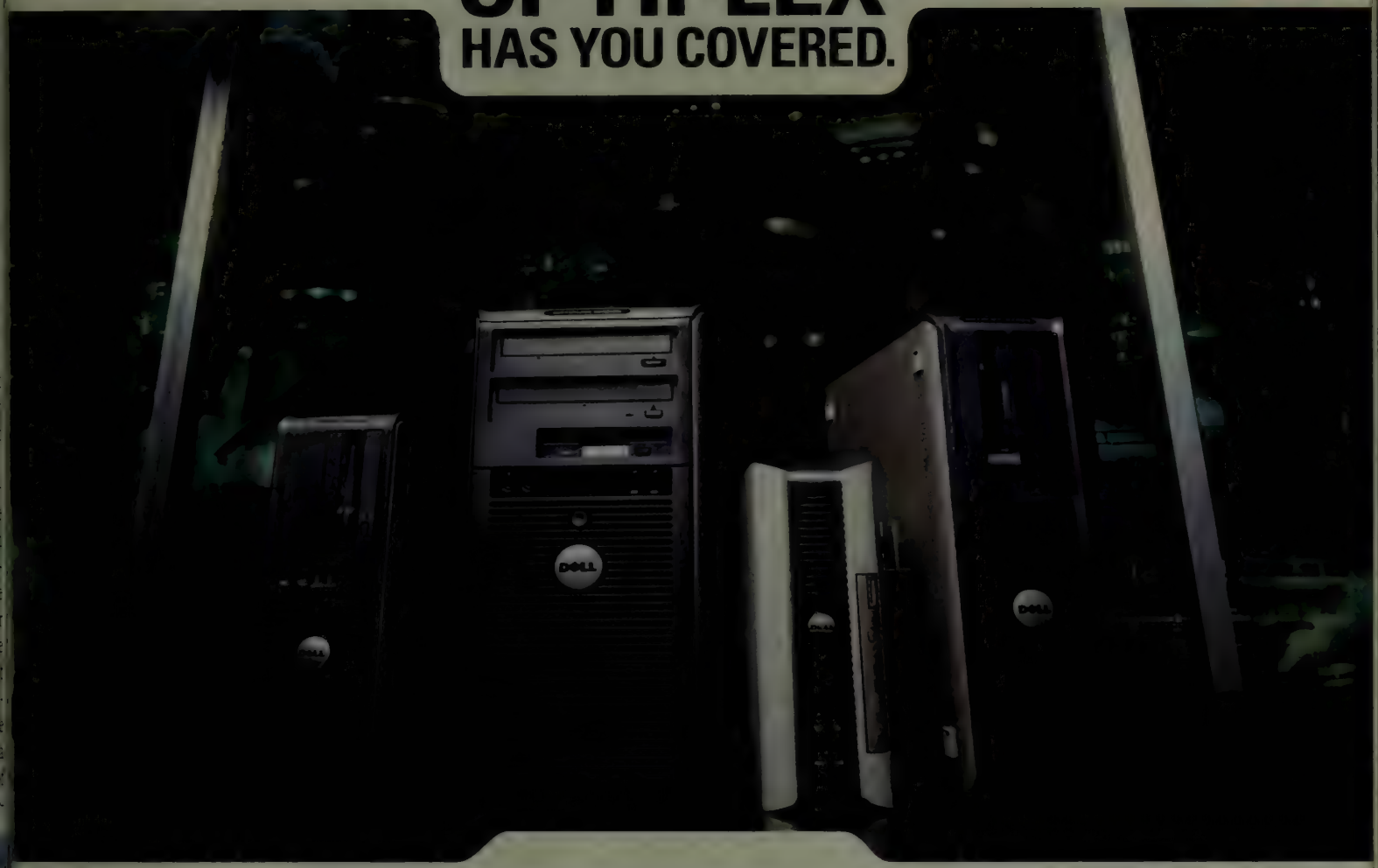

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Joan Mira, 54. Attorney. Son Jordan attends private college in Chicago. Joan hopes to retire and open a coffee house. She'd like to call it "Joan's Place."

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RAYMOND JAMES

ous about their work. They post nev episodes every weekday morning, begin ning the process by looking online fo news and reading through suggestion from viewers and six correspondents in th U.S. and Europe. After e-mailing the scrip back and forth, they meet around 6 p.m. i downtown Manhattan to record the show in a pea-green conference room in a turn of-the-century building.

SUBSCRIPTION FEE?

TAPING USUALLY takes about an hou and a half. The duo have detailed discus sions about whether to throw out certai lines or how Congdon should move he head. One evening in late July, they do 1 takes for a 20-second segment on couple using their own bone chips to grow ring —for jewelry. They jettison one joke an work out the length of a pause before th punch line. On the final take, Baro watches Congdon intently through th camera. "The process takes a month," sh says, pausing slightly before cocking he eyebrow. "But the results last a lifetime." She continues looking into the camera until Baron, in his Texas Hill Country ac cent, says: "I think that's it, don't you?" After the taping, Baron heads to his Up per West Side apartment to tackle the ed iting, typically two to three hours more.

With Rocketboom's one-year anniver sary approaching, the duo are planning their next steps. In the fall, they'll experi ment with a subscription fee of arounc $3.50 a month. The three-minute show

The Download on Rocketboom

Only 10 months old, Rocketboom has become the most popular video blog on the Net. Here's the skinny on the site:

WHAT A three-minute mock news show.

WHERE On the Web at Rocketboom.com.

WHEN New shows are posted Monday through Friday at 9 a.m. All previous shows are available in the archive.

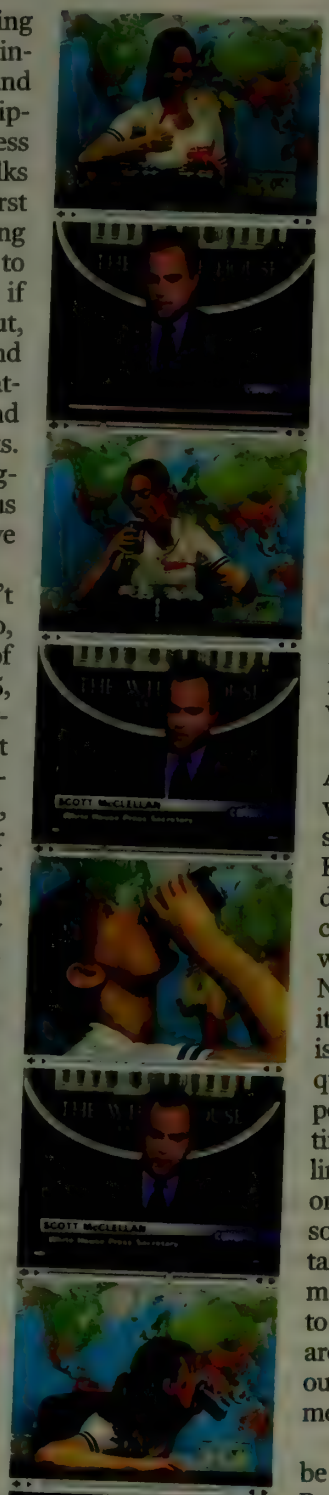
WHO Former musician Andrew Michael Baron founded Rocketboom and brought in actress Amanda Congdon as the breezy blonde anchor and co-writer.

HOW The show combines sly, humorous news reports, à la Comedy Central's Jon Stewart, with the community dialogue of a blog. Viewers post praise or critiques, suggest topics to cover, and send in their homemade videos for use on the show.

will remain free, but paying customers will get extras, including longer shows and outtakes. Although subscriptions have had spotty success online, the Rocketboom folks want to test this route first rather than potentially having to change their show to please advertisers. Still, if subscriptions don't pan out, they'll turn to ads to fund their ambitious plan of creating a network of shows and hiring writers and hosts. "We have big ideas," Congdon says. "People laugh at us all the time, but we figure we have to start somewhere."

For two people who didn't know each other a year ago, they share a strong sense of mission. Baron, now 35, spent his 20s in Austin playing in bands, running an art gallery, and supporting himself with tech jobs. In 2001, he moved to New York for grad school, studying computing and video at Parsons School of Design. The flurry of online videos during the Presidential election was an epiphany for Baron, who hasn't owned a TV in a decade. "Suddenly, online video was easy," he says. He came up with the idea for a mock newscast and posted an ad for an actress on the online ad service Craigslist last summer. After getting 450 responses, he hired Congdon for $50 a show in September.

At the time, Congdon knew little about technology and even less about blogging. The 24-year-old comes from an acting family; both her parents worked on Broadway. She dove into drama a couple of years ago after studying communications at Northwestern University and working briefly at ad agency Saatchi & Saatchi. A whirl of jobs followed an appearance as the coat-check girl on NBC's *The Restaurant* in 2004, but that had slowed by the time Baron posted his ad. After first meeting him at a little studio in Chinatown, she was won over and has become a co-owner of the business.



DRINKING GAME Each time a White House spokesman ducks a question, Congdon pretends to take a swig

"This is something so innovative, I wouldn't want to stop doing it," she says. "I feel almost as if we could end up in history books."

While Rocketboom looks like an offbeat news show, it's like a typical blog in how it fosters a community. The site uses videos sent in by viewers and is building up a network of correspondents. The latter include Zadie Diaz in Los Angeles and Chuck Olsen in Minneapolis, who report on local happenings for $50 a piece. In July, Diaz stopped into a comic book convention in San Diego, sending in a comic book-like collage of mock light-saber fights and people walking the floors in Superman and Willy Wonka costumes.

Established outlets, such as ABC and CBS are tracking video blogging and taking some tentative steps. Larry Kramer, the new head of CBS's digital efforts, is plunging into creating traditional blogs that will have some video. ABC News agrees it needs to reach its audience wherever it is, but is more skeptical of the overall quality of today's video blogs or podcasts. While both are putting more traditional video online, neither plans stand-alone ongoing video blogs, which some observers think is a mistake. "Rocketboom is a great model that could be used to try to leverage all this talent sitting around CBS, ABC, and the other outlets," says Merrill Brown, a media consultant.

Major broadcasters may not be paying close attention to Rocketboom, but others are. New video blogs are popping up every day and many are closely tracking Baron and Congdon's attempts to build a business around their budding popularity. "Once Andrew can figure out a business model that other people can copy, we will have a thousand Rocketbooms," says Jay Dedman, co-founder of the pioneering Videoblogging.info community group. So if you've got 200 cable channels and nothing to watch, rest assured. More choices are on the way. ■

–By Heather Green in New York

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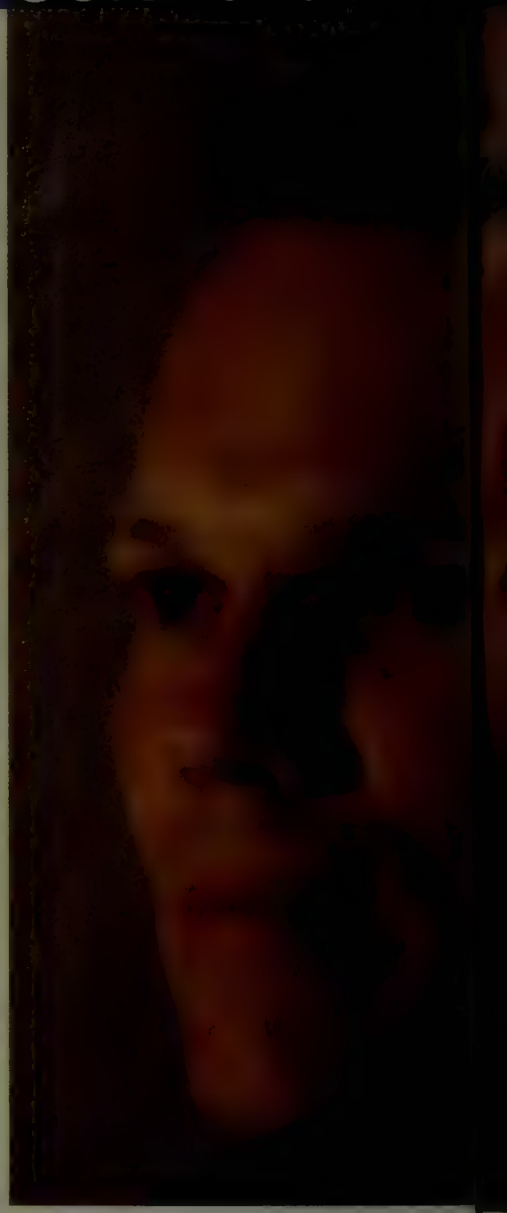
How To Face Off Against Microsoft

Intuit has repelled the software giant six times. Now it's defending its largest business



THINK OF IT AS THE TECH industry version of a preseason football scrimmage. On May 10, Intuit Inc.'s top 40 managers decamped from their Mountain View (Calif.) campus for a hotel in nearby Palo Alto. They were divided into two groups: one representing Intuit, the other archrival Microsoft Corp. The Microsoft team came up with a plan of attack against Intuit's small-biz accounting software, QuickBooks. Team Intuit responded. Throughout the day, the mastermind behind the event, QuickBooks General Manager Brad D. Smith, sent out mock press releases with titles such as "Microsoft slashes prices," forcing both teams to scramble.

Smith's goal: to train Intuit managers to handle the equivalent of football's no-huddle offense. "You've got to be able to go out, read the situation in real time, and have a set of scenarios in your back pocket," says the 41-year-old, who attended West Point and worked at PepsiCo Inc. and check processor ADP. "The decision-making power is out in the front lines because that's where the action happens."

On Sept. 7 the role-playing becomes reality. Microsoft is expected to release a new software product, Microsoft Small Business Accounting, in a direct attack on QuickBooks. The giant is angling for a chunk of the $600 million small-business accounting market dominated by Intuit. Two months later, Intuit will respond with a new, improved QuickBooks, codenamed Denali. The outcome is crucial for Intuit since the QuickBooks franchise accounts for more than 40% of its revenues. Indeed, this is the biggest threat from Microsoft since it took aim at Intuit's Quicken checkbook software in the 1990s—a brutal battle that Intuit eventually won.

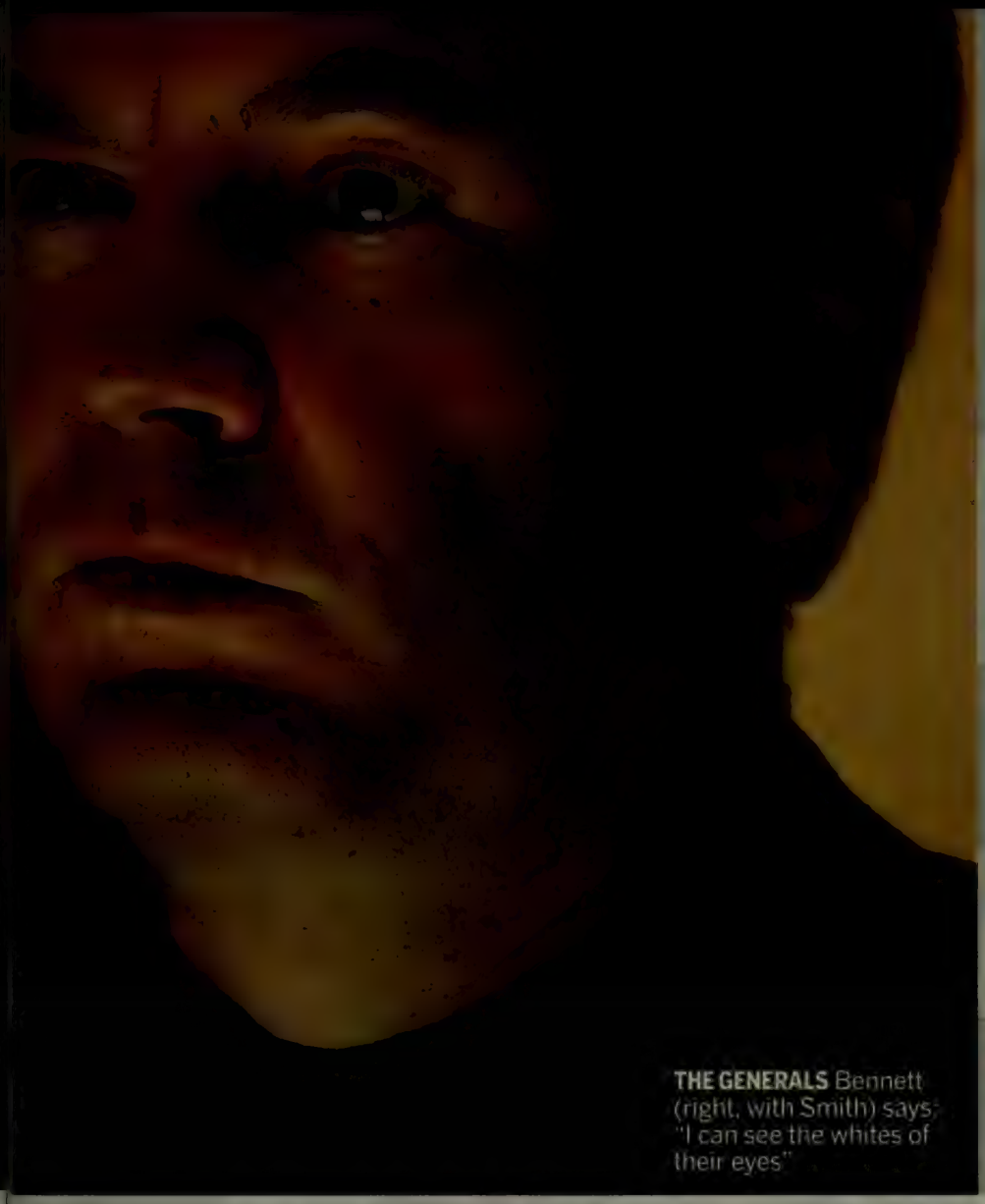
It's also a critical moment for Intuit Chief Executive Stephen M. Bennett. After arriving five years ago from General Electric Co., Bennett took a company with a stellar reputation for customer relations and focused intensely on execution, increasing revenues from $801 million in 1999 to $1.8 billion last year. Operating margins jumped from 15.6% to 25.7%. Yet this is the first serious new threat from Microsoft with Bennett at the helm, and he's eager to prove himself. "I knew they were coming when I took this job," he says. "And I can see the whites of their eyes now."

Intuit gets more than 40% of its sales from the small-biz market

His strategy: keep doing the things that have made Intuit successful, with a surprise or two to knock Microsoft off balance. Intuit is known for its easy-to-use products. Now it's simplifying the user interface even more and adding sophisticated features in higher-end versions, such as improved auditing capabilities. One surprise came on Aug. 24 when Intuit, at Smith's urging, broke with its long-standing tradition and preannounced the new QuickBooks package. Smith wanted customers to know Intuit had something right around the corner when Microsoft launched Small Business Accounting.

Microsoft brings potent weapons to the fight. Many small businesses already use its Excel spreadsheet for accounting and Outlook for client management. While Microsoft has been selling accounting software to small businesses for several years, this is the first time it has designed a product specifically for them—it even hired cultural anthropologists to learn their ways. The results struck a cord with bookkeeper Mae Farrow of Ironwood Self Storage in Idaho Falls, Idaho. She switched to the test version of Small Business Accounting because it's more sophisticated, offering double-entry accounting rather than the simple checkbook-style process in QuickBooks. "I do not enjoy using QuickBooks because it was not made for someone who knows what they are doing with books," she says. Microsoft officials declined to comment prior to their announcement.

There's enough doubt to make it a lively contest, but analysts are betting on Intuit. Most believe Intuit will beat back the challenge thanks to its intense focus on the market—while Microsoft is spread out. Intuit has been catering to small businesses for a decade and responding quickly to their shifting needs, plus it has a network of 200,000 accountants who



THE GENERALS Bennett (right, with Smith) says: "I can see the whites of their eyes"

Intuit's **Battle Plan**

On Sept. 7, Microsoft will take on Intuit's biggest revenue generator—its QuickBooks small-business accounting software. Here are the elements of Intuit's counterattack:

BEAT 'EM TO THE PUNCH Intuit broke with its usual tactics and pre-announced its new QuickBooks release, code-named "Denali." The unveiling came on Aug. 24, even though Denali won't hit stores until November, so that Intuit can get ahead of Microsoft's September product launch.

JAZZ UP RETAIL SELLING Intuit will repackage all of its QuickBooks versions so it's clear what kind of business each one targets. It also plans aggressive promotions and rebates.

WIN OVER BEAN COUNTERS Independent accountants have a tremendous influence over their clients' software choices, so Intuit is conducting an 80-city evangelizing tour to whet their appetites for the new versions.

IMPROVE SERVICE Intuit has reorganized its call center in Tucson. Now, when a small business calls with a question, it will get an expert in its specific flavor of QuickBooks, not a generalist.

recommend QuickBooks. As a result, Intuit has an overwhelming 74% market share at retail and 3 million customers.

One of QuickBooks' key advantages is its SimpleStart version. At a cost of just $99, it's aimed at first-timers such as Leslie Anderson, owner of classic car dealership Blue Oval Ranch in Salem, Ore. Thanks to its simplicity, the software saves her 10 hours a week on bookkeeping. "I needed something I could just let do the work for me," she says. Intuit's lock on the smallest businesses, like Anderson's, seems likely to hold up, since Microsoft's product is expected to run $200 and is crafted for larger and more sophisticated outfits. Landing customers when they start out gives Intuit a better chance of keeping them as they grow.

Small-business accounting software has been Bennett's pet project since he became CEO in 2000. Sales were solid, but he knew they could be better. "We were fat, dumb, and happy," he says. So he used QuickBooks as a model for how Intuit could improve. He even put in two stints leading the business unit.

When Bennett was hired, there were only two QuickBooks products, Basic and Pro. But Basic was too complex for companies with just a few employees, and Pro was too constrictive for companies with more than 20 staffers. He has since added 21 versions, including one for companies with as many as 250 employees, packages for particular industries, and SimpleStart. Analysts say this strategy has put Intuit in a much stronger position for a fight with Microsoft. "If I'm a small business, I know I can grow with Intuit. They have a road map," says analyst Mika Krammer of market researcher Gartner Inc.

"A PASSIONATE LEADER"

BUT BENNETT KNEW he needed to do more to beat back a frontal assault from Microsoft. When he learned last November that Microsoft had a QuickBooks-killer in the works, he launched a series of strategy sessions aimed at beefing up the features in Denali and coming up with an aggressive marketing push.

Bennett's smartest move may have been picking Smith to run the campaign. Smith had proved himself by boosting Intuit's tax-software business, TurboTax, in just one year at the helm. After customer research showed that only about a quarter of tax filers were comfortable using software to do their taxes, he went after first-timers through marketing outreach partnerships with hip-hop impresario Russell Simmons, retailer Best Buy, and travel site Expedia.com. The result: Unit sales rose 27%, and Intuit boosted its market share from 70% to 78%.

Smith, a fast-talking, self-described "hillbilly" from Kenova, West Virginia (pop. 3,500), contrasts sharply with Bennett's controlled GE style. Bennett knew he had a good strategy but needed a passionate leader to rally the troops. "Brad is one of the best I've ever seen at winning the hearts and minds of employees," he says. When Bennett asked Smith to run Quick-

Books in May, Smith didn't hesitate. "Anytime there's a scrap out there, I'll sign up for it," he says.

After he took the job, Smith dove right in. At a July 20 staff meeting he gave every QuickBooks worker a copy of a children's book, *The 300*, recounting the tale of how 300 Spartans fought off a Persian army of thousands. Reading the synopsis of the battle on the back cover, he paused, shivered, and said: "I feel ready for a group hug!" to applause and laughter. Smith displays the book and a small Greek action figure in his sparse office. "Yes, it's Microsoft, and their assets look vast. But this is Intuit. We know what we stand for, and we've seen them before," he says. "So they can bring it on."

ROUND SEVEN

INDEED, INTUIT HAS SEEN Microsoft many times before. They've had six previous head-to-head contests—all of which Intuit has won. The last time the two tangled, it was over tax-preparation software. After much anticipation, Microsoft released TaxSaver in late 1999 but withdrew from the market in March, 2000, before the tax filing deadline. Despite its brand name and marketing power, it had won only 4% market share.

It's hard to believe Microsoft will do as poorly this time, but early signs are that QuickBooks will prove hard to dislodge. Farrow, the self-storage proprietor who's switching to Small Business Accounting, acknowledges that four companies who use her to do their bookkeeping are sticking with QuickBooks. Steven Menasche, owner of martial arts studio Hapkido Institute in San Francisco, thought about switching from QuickBooks because he liked the idea of integrating Microsoft accounting software with Microsoft's Outlook e-mail and other products. But he balked in the end. Some technical glitches in the beta version factored into his decision. Even more important, his wife, who has done consulting work for dozens of small businesses, is "fluent" in QuickBooks. "If I went with Microsoft, she couldn't help me," he says.

That kind of grassroots popularity might be Intuit's biggest edge. According to Intuit founder Scott Cook, now chairman of its executive committee, when Bill Gates proposed a merger with Microsoft in 1995, he told Cook: "I can copy your products, but I can't copy your word of mouth." Ten years later, it's still true. And that bodes well for the home team. ■

–By Sarah Lacy in San Mateo, Calif., with Jay Greene in Seattle

Maybe in My Backyard

High fuel prices and global warming are making nukes an easier sell

HOBBLED BY IMAGES OF Three Mile Island and Chernobyl, staggering costs, and opposition from enviros and politicos, nuclear power once seemed destined to go the way of the dodo. "Just five years ago, utility executives were saying they wouldn't be caught dead even talking about a new plant," recalls Massachusetts Institute of Technology nuclear engineer Andrew C. Kadak. U.S. utilities were shutting reactors, and Germany planned to pull the plug on its facilities.

Today, nukes are on the verge of a global comeback. A new plant is under construction in Finland, the first in Europe since 1991. France, which already has 58 plants, says it will build 30 more. China plans to spend $50 billion on atomic energy construction by 2020. In the U.S., where 103 existing reactors have become cash cows, a dozen companies are seriously considering building new plants. And the energy bill signed by President George W. Bush on Aug. 8 has billions of dollars in subsidies. "Things have never looked better," says Dan R. Keuter, vice-president for business development at Entergy Nuclear in New Orleans.

What's fueling this resurgence? In a word, economics. Rising natural gas and

BYRON, ILL. Some areas are actively seeking new plants

coal prices are starting to make nukes look inexpensive. Another factor is global warming. Not only do new restrictions on emissions of carbon dioxide increase the costs of fossil fuel-generated electricity, fears of climate change have softened opposition among some enviros. While the government must still solve problems of waste and security, says Steve Cochran of Environmental Defense, "given the challenge of climate change, the world needs to be open to every low carbon initiative—including nuclear power."

Construction in the U.S. won't start tomorrow, however. There are still major uncertainties. Natural gas prices must stay high to make nukes economical. With increasing imports of liquefied natural gas, that's not a sure thing. Utilities must also convince Wall Street that the long delays and huge cost overruns that doomed N-power in the 1980s won't happen again.

As a result, companies say they won't order a new plant until they are sure they can get a license from the Nuclear Regulatory Commission, a process expected to take four to five years. "At the very earliest, we are looking at construction starting around 2010," says Adrian Heymer, director of new plants deployment at the Nuclear Energy Institute. Since construction would take four to five years, electrons from the new nukes couldn't start flowing until 2014 or 2015 at the soonest.

New nukes won't come on line until 2014—at the earliest

It could be longer than that. John W. Rowe, chairman and CEO of Exelon Corp., believes that a new generation of reactors is essential. But even though Chicago-based Exelon is the nation's biggest nuclear utility, with 17 reactors, Rowe says the risks are still too great to order new plants now. "While the stars and moons are moving in the right direction, they're not there yet for us," he says.

FRUSTRATION FACTOR

THE LACK OF immediate action frustrates Washington politicians, who crafted energy legislation that, among other things, was designed to make nukes nice again. The bill offers government loan guarantees so that banks won't demand a risk premium when financing new reactors, and a production tax credit. It also provides up to $2 billion to cover costs associated with regulatory delays. That's on top of changes Congress made to the licensing process in 1992. "For anyone who says there is still too much regulatory uncertainty, I have to question how serious they are," says one Senate staffer. Congress has "piled yet one more security blanket on the pile of blankets," he says.

Industry execs insist that new plants will be built, but say they are getting there one step at a time. "No one would make a decision to order a plant now," explains Michael J. Wallace, executive vice-president of Constellation Energy Group. The Baltimore utility and others, however, are already partway there. Entergy, Exelon, and Dominion have filed applications with the NRC to get three sites licensed for new reactors. Reactor makers Westinghouse, General Electric, and Areva, which is building the Finland plant, have filed or will soon file applications to get new designs certified by the agency. A group of eight U.S. power companies, called NuStart Energy Development, is working on applications for construction and operating licenses for the GE and Westinghouse designs.

Meanwhile, the public has become more accepting. The percentage of Americans who favor nuclear power jumped from 46% in 1995 to 70% in May, 2005, according to Bisconti Research. Some communities are actually backing new plants. In Calvert County, Md., where Constellation Energy has proposed adding a new reactor to an existing facility, "we are doing everything we can to see that kind of investment made in the county," says David Hale, president of the county board of commissioners.

There have also been technological improvements. The basic approach hasn't changed, but new designs are easier to build and operate—and better able to handle problems. They are "more safe by an order of magnitude," says MIT's Kadak. The industry expects progress on the waste front as well. New radiation exposure limits proposed by the Environmental Protection Agency for the Yucca Mountain repository in Nevada in early August could pave the way for the facility to eventually accept waste.

Add it up, and nukes no longer look like dodos. "What we are seeing is an economic change that is beginning to overwhelm the construction and licensing risks," says Thomas A. Christopher, CEO of Framatome ANP Inc., a unit of France's Areva. A new 1,000-MW plant is expected to cost at least $1.5 billion. That compares with $1.2 billion for a new coal plant or $500 million for a gas-fired facility, which is quicker to build. But utilities have learned to run reactors more efficiently, making existing nukes cheap producers of power.

Now they figure that with natural gas prices tripling and coal prices doubling over the past five years, new nuke plants will be gold mines. "What we have to do is build the first two to six plants and prove to Wall Street that we can do it on schedule," says Entergy's Keuter. If that happens, the mid-21st century could be a new Atomic Age. ■

–By John Carey in Washington, with bureau reports

Nukes: Gaining Acceptance

Are you in favor of nuclear power as a source of electricity?

1995	2005
46%	70%

Based on telephone surveys of 1,000 adults, with a margin of error of plus or minus 3 percentage points

Data: Bisconti Research

AT WISCONSIN Erin McLennon is getting an arts administration MBA

B-Schools With a Niche

With applications falling, mid-tier programs are crafting specialized degrees

TWO YEARS AGO, THE University of Wisconsin-Madison's School of Business was in trouble. Like many of its peers, it had seen full-time applications drop 30% in three years, and the situation was likely to get worse. So Michael M. Knetter did something a lot more deans are doing these days: He specialized.

Scrapping the general management MBA altogether in 2004, he replaced it with 13 distinct degrees in everything from arts administration to applied corporate finance. The result: a smaller but smarter class, with admissions test scores up 25 points. Says Knetter: "We want to be the school of choice for students who have a clear vision from the outset."

While the Harvards and Whartons of the world aren't facing similar problems, mid-tier schools like Wisconsin increasingly find themselves in a crowded field. To stand out from the pack they're creating specialized programs that give students the kind of targeted, real-world experience sometimes lacking in traditional MBAs. Across the country, these schools are developing MBAs that focus on health care, real estate, even sports management.

As a strategy, specialization seems to be working. At many schools that have pursued it, the decline in applications has stopped, and in at least one case, even reversed. At Boston University's School of Management, there was a 29% increase in applications in 2005, four years after it combined an MS in information systems with an MBA. At schools where the application decline has proved irreversible, the specialized programs have attracted prospective students with higher Graduate Management Admission Test scores. Now student satisfaction is up, with fewer applicants turning down admission offers—all of which may ultimately result in higher rankings.

BROAD VIEW

HOWEVER, NO STRATEGY is perfect. By defining their mission too narrowly, schools run the risk of producing graduates with limited career choices, or alienating big recruiters—especially consulting companies—for whom the general MBA is preferable. Says Rich Schneider, a principal at Deloitte Consulting LLP, where he heads up the MBA recruiting practice, "B-schools need to ensure they're giving their students well-rounded capabilities. We're still looking at the things we were looking for 30 years ago."

Cognizant of that fact, some schools have concentrated their offerings on management specializations that have broad applications, such as leadership, creativity, and entrepreneurship. At Emory University's Goizueta Business School, leadership has been the program's focus since 2003. Students now take four first-year courses on the subject and are videotaped five times a year to an-

Pick an Industry

Creating specialized programs, like health care MBAs or sports management MBAs, allows mid-tier schools to stand out

PROS

- Specialties often attract focused, dedicated students with higher test scores
- Companies often supply targeted internships and career opportunities
- Focus on a single industry creates a more cohesive program

CONS

- Focus on a specialty could gloss over the basics, such as finance or marketing
- Narrower appeal could result in a smaller pool of applicants
- Less diverse student body might diminish educational experience

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alyze public speaking skills. Says Associate Dean Kembrel Jones, "You need to do one thing and do one thing better than anybody else."

BASEBALL SYLLABUS

BUT WITH VIRTUALLY every MBA program in America claiming to teach so-called soft skills to some extent, schools that focus on them may be hard pressed to differentiate themselves. That's why many schools are choosing instead to build their specialties around specific industries. Rutgers Business School in Newark, for example, has offered a pharmaceutical management MBA since 2000 in partnership with seven area drug companies. And this year, San Diego State University launched an MBA program in sports management with the help of the hometown baseball team, the Padres.

Other schools have gone a different route. Some have transformed their programs into what amounts to a consulting firm, dispatching eager young MBA students to some of the world's biggest companies to solve their problems. For students at University of Minnesota's Carlson School of Management, that means spending 20 hours a week for three semesters doing everything from developing a new route for Northwest Airlines cargo service to streamlining operations at nearby Marvin Windows & Doors, where the students saved the company $1 million in operating costs. Says Interim Dean Michael Houston, "I want students leaving here better prepared than any other MBA student in the country."

Grads may face limited career choices

For mid-tier schools, battling it out with dozens of others for an ever-shrinking applicant pool doesn't have to be a permanent condition. By focusing their programs on a few well-chosen specialties, they believe they can make their degrees something they have never been before: a ticket to career success on par with the top-ranked B-schools. Not a bad approach, considering the alternative. ■

–By Lindsey Gerdes in New York

BusinessWeek online For a Q&A with the dean of Toronto b-school, and a list of other specialized MBA programs, go to businessweek.com/extras

Slimmer Kids, Fatter Profits?

Charles Davis, a Kraft food maven, is on a health kick. But then, he has no choice

MAKING CHEESE healthier is complicated. Add too much calcium, and it starts to taste chalky. Take out too much fat, and the cheese emerges from mechanical graters like Play-Doh. "It becomes a big glob instead of having good shredding integrity," says Charles W. Davis, vice-president of global technology and quality for convenient meals at Kraft Foods Inc.

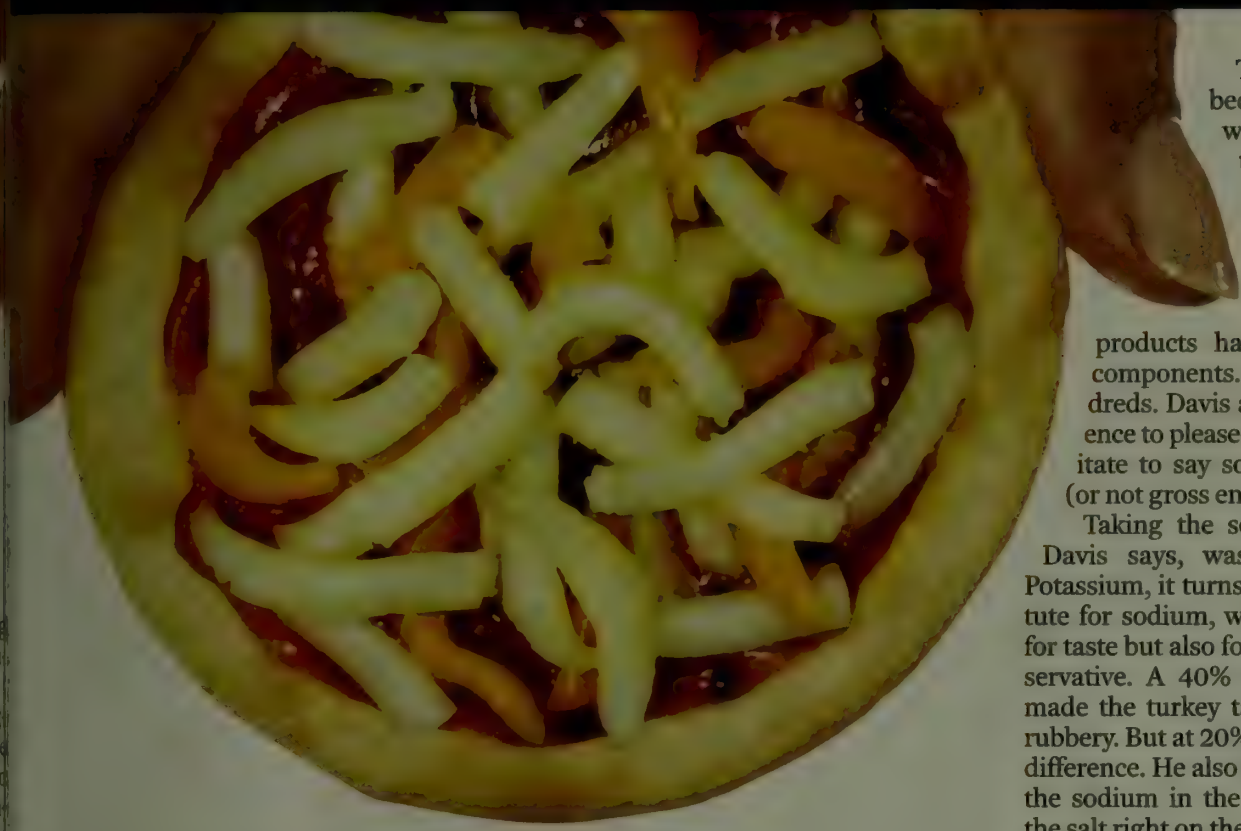
Davis can tell you all about finding that delicate balance between what tastes good and what's good for you. Since 2004, the 48-year-old chemist has been leading a team of scientists, technicians, and engineers working to improve the nutritional content of Kraft's popular Lunchables Lunch Combinations line, a process known industrywide as reformulation. That means he has spent an inordinate amount of time experimenting not only with cheese but also with the juice drinks, crackers, deli meats, and fruit snacks that make up these all-in-one meals. If you count all 41 varieties of Lunchables, Davis has cut calories by an average of 10%, fat by 24%, and sodium by 20%.

PIZZA DE RESISTANCE Davis' revamped Lunchables best-seller makes its debut this fall

Why do Davis and hundreds of other people throughout the company do nothing else but experiment in their kitchen labs all day? Because their employer has no choice. Kraft, the nation's biggest food manufacturer, and its competitors are becoming this decade's cigarette companies: vilified for pushing junk to children, restricted by often-conflicted regulators, challenged in court.

At Kraft, which was spun off from cigarette maker Altria Group, there is little appetite for those kind of problems. Two years ago the company saw trouble coming and devoted a major portion of its $350 million-plus research and development budget to making its food healthier. Since then, Kraft has reformulated some 750 products, or more than 10% of its total sales by volume, and trimmed about 65 billion calories from consumers' diets. The company is even working on its iconic Oreo cookie to eliminate trans fats. "This is the single largest reformulation effort ever undertaken by the company," says Lance Friedmann, senior vice-president for global health and wellness.

The scientists' work is one piece of an even bigger health kick at Kraft. Every product that meets certain standards, which are based on U.S. dietary guidelines, is marketed as part of its Sensible Solution program. Kraft has also introduced 100-calorie packs of snack foods, such as the Wheat Thins Minis, and rewritten nutrition labels to include the entire contents of a small package, not just a single, impracticably dainty serving. At the start of the year, Kraft went so far as to announce that it would stop hawking junk food



in media that target kids under 12.

Aside from legal and PR worries, there's another reason for Kraft to take the issue of nutrition seriously: The $53 billion company fully expects to profit from it. Food sales usually increase in small increments each year, generally as much as the population grows. But for the past two years Kraft's profits have declined, in part because of strong competition here and in Western Europe; its operating income in 2004 fell from $5.9 billion on revenues of $30.5 billion to $4.6 billion on revenues of $32 billion. Better-for-you foods offer companies a chance at faster growth and fatter profits. Sales of organic foods, for instance, have increased by 20% a year since 1997, according to the Organic Trade Assn.

Lunchables sure could use some of that juice. The line, first introduced by Oscar Mayer in 1988, has an 85% share of the $750 million market for prepackaged kids' lunches. But increasing competition, even from products such as Go-GURT, and a declining reputation among parents meant that sales increased by just 1.5% in the past year. Kraft hopes a leaner menu will get the meals back into lunch boxes. Will parents and kids bite? Possibly. Davis' team launched all-white meat chicken nugget Lunchables last year, new healthy meals. They are the fastest selling products in the portfolio.

'BALL OF ENERGY'

DAVIS, WHO TALKS as quickly as a 10-year-old on a sugar high, joined Kraft while studying at the University of Massachusetts in Lowell, met his wife on the job, and earned his bona fides with Crystal Light Lemonade in the early 1980s. More recently, he worked a nutritional world away on the launch of Philadelphia Cream Cheese dessert bars. In 2004 he moved to the convenient meals group, taking on the Lunchables makeover. "He's a ball of energy," says Friedmann.

That's a good thing, because Lunchables, which were inspired by the Japanese *bento* box, is one of the most complicated reformulation projects under way at Kraft. Most food products have only one or two components. Lunchables has hundreds. Davis also has a tough audience to please—kids, who won't hesitate to say something tastes gross (or not gross enough, for that matter).

Taking the sodium out of turkey, Davis says, was particularly tricky. Potassium, it turns out, is a good substitute for sodium, which is used not only for taste but also for texture and as a preservative. A 40% reduction in sodium made the turkey taste metallic and feel rubbery. But at 20%, kids couldn't tell the difference. He also figured out how to cut the sodium in the crackers—by putting the salt right on the Ritz. That may sound counterintuitive, but the initial flavor burst fools eaters into thinking they've got something saltier than they really do.

Davis' pièce de résistance, however, is the new Extra Cheesy Pizza and Pepperoni Flavored Sausage Pizza. They took nearly a year to develop and are hitting stores just as kids head back to school. Davis is anxiously awaiting the results: Pizzas have traditionally been best-sellers, accounting for 30% of the Lunchables' sales.

No ingredient was overlooked. He replaced the butter in the pizza crust with soybean oil to cut the trans fat. Instead of a chocolate dessert, there is a fruit-flavored one. The two revamped products have virtually no trans fat and 200% more fiber than before, and are the first reformulated Lunchables to meet the Sensible Solutions guidelines. Says Jeanne Goldberg, a professor of nutrition at Tufts University: "It's a step in the right direction." Now if Kraft can just slim down the Oreo.

–By Adrienne Carter in Madison, Wis.

A Tale in **Numbers**

The skinny on the new, healthier Extra Cheesy Pizza Lunchables

	CALORIES	FAT	CHOLESTEROL	SODIUM	CARBOHYDRATES	FIBER	SUGARS	PROTEIN
BEFORE	470	16g	30mg	770mg	66g	1g	36g	19g
AFTER	450	11g	25mg	670mg	72g	3g	36g	17g

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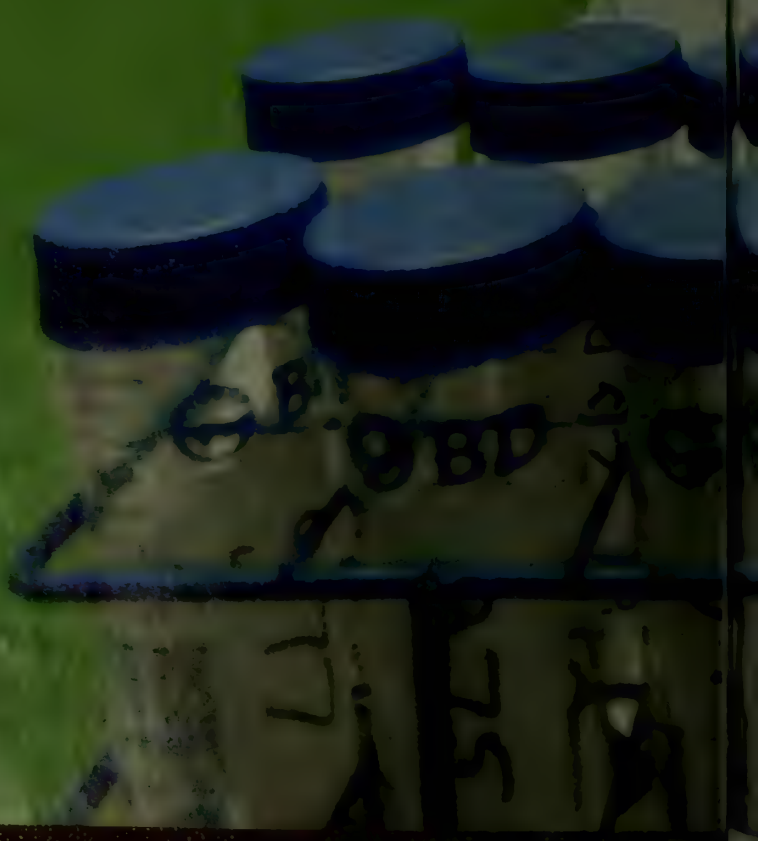
DRUGS GET SMART

New medicines will more effectively target what ails you—and help prevent another Vioxx

BY KERRY CAPELL AND MICHAEL ARNDT, WITH JOHN CAREY

On the day Dr. John P. Kane began his residency at the University of California at San Francisco Medical Center in 1959, he got a phone call. His father, Paul—a retired Army general who had survived combat in both World Wars, never smoked, and had no apparent health risks—had just died of a heart attack at 66. The news propelled Kane into the field of cardiology. Nearly a half-century later, his discoveries may alter the treatment of the No. 1 killer in the industrialized world: heart disease.

Kane spent much of his first two decades as a doctor doing research that helped link high cholesterol to heart attacks. In 1985, he began collecting samples of DNA, believing that genes must play a role as well. Now 72 and still logging 11-hour days, seven days a week, Kane has scrutinized 10,000 genes, nearly half the human genome, so far. He has



BECAUSE OF DR. KANE'S RESEARCH, PHYSICIANS MAY BE ABLE TO PREDICT WHO'S AT RISK FOR SPECIFIC TYPES OF HEART DISEASE

RICHARD MORGENSTEIN

identified 20 variations that seem to mark the people who carry them for heart attacks.

Working with his longtime lab partner and wife, Dr. Mary J. Malloy, at the UCSF Cardiovascular Research Institute, Kane has reached some surprising conclusions: At least half of the genetic variations linked to heart attacks bear no obvious relation to cholesterol levels, blood pressure, or any of the other usual suspects in heart disease. Instead, they strongly suggest mechanisms such as inflammation, which can be caused by an infection or by a haywire immune system. That implies that there may be several forms of heart disease, just as there are multiple forms of breast and lung cancers.

If Kane is right, doctors might be able to screen patients' DNA and predict not only whether they are likely to have a heart attack but which type of heart disease to expect and which drug or procedure might work. Instead of prescribing a cholesterol-lowering pill such as Lipitor reflexively, they might choose an anti-inflammatory, for example. Other experts share Kane's conviction, including executives at Celera Diagnostics, an Alameda (Calif.) outfit co-founded by genomics pioneer J. Craig Venter. Celera hopes to have a genetic test for heart disease on the market in a few years, based largely on Kane's research. "We're embarking onto the open sea," says Kane, "and we're discovering things that nobody knew about."

Historians have called the late 19th century "the great flowering" of medicine. Thanks to advances in microscopy and a deeper understanding of germs and human physiology, scientists were able to identify the cause of one infectious disease after another. Today, despite headline-grabbing fiascos like Vioxx, medicine is on the verge of a second flowering. This time the findings may improve the treatment of everything from heart disease to cancer, depression, Alzheimer's, and autoimmune disorders. Doctors are calling it the age of "personalized medicine" as they close in on genetic variations that hint at why one person responds to a drug and another doesn't, why some people are prone to strokes or heart disease, why one person's cancer is more aggressive than another's.

The shift to drugs tailored to a specific genetic profile will bring massive changes to a pharmaceutical industry long wedded to treatments that can be taken by millions upon millions. Most prescription medicines are now effective for fewer than half of the people who take them—and the side effects can be worse than the illnesses. "From a strategic standpoint, of meeting the needs of our customers, the current blockbuster model doesn't work," concedes Sidney Taurel, chairman and CEO of Eli Lilly & Co.

Drugmakers suffer mightily when a blockbuster fails—as demonstrated by Merck & Co. On Aug. 19 a Texas jury returned a $253 million verdict against Merck for the 2001 death of a patient who had been taking the painkiller Vioxx. And that's only the first of thousands of Vioxx lawsuits, which could leave the company reeling.

Merck pulled Vioxx from the market last fall after it was linked to heart attacks and strokes. Although scientists suspect that Vioxx is safe for the vast majority of patients, the drug can dramatically increase the risk of blood clots for a few. But there is no test to reveal who can take the pill safely and who can't.

Well before the Vioxx troubles, Big Pharma and biotech were beginning to explore personalized medicines. Those efforts should pick up momentum, says Robert Goldberg, director of the Center for Medical Progress, a public-policy think tank. "If drug companies do not go the route of understanding and responding to the tremendous genetic variations in how we react to medicine," he says, "you'll see more litigation, not less."

THE AMPLICHIP FROM ROCHE GAUGES THE GENETIC RESPONSES TO MEDICATIONS

Getting to that understanding is still a challenge because illness is never a simple phenomenon. Researchers have shown that there are many varieties of breast cancer and leukemia, and the same is surely true of other cancers, coronary disease, and neurodegenerative ailments—with each variety afflicting different subsets of people based on genetic vulnerability. Doctors are seeking to identify differences among groups through DNA tests, hoping that treatments can be tailored as well. Ultimately, each of us should receive the drugs that work best, based on the subset dictated by our genes.

Personalized medicine is set for a natural progression. First, genetic screening will yield more accurate diagnoses. Next, doctors will prescribe medications that will help, not harm. Finally, there will be an explosion of treatments for specific populations. That doesn't mean doctors will handcraft pills for each patient, but there will be more effective treatments, less waste—and much less Vioxx-style collateral damage.

A milestone was the completion in 2003 of the mapping of the entire human genome—the 25,000 genes coiled in the chromosomes of every cell. Since then, databases of DNA have been assembled with samples from tens of thousands of people. By comparing genes, researchers can link variations and mutations to all sorts of illnesses. Kane, for instance, has a database of specimens from 20,000 people. He starts with samples from people who have had heart attacks or shown signs of heart disease at early ages. He then compares their genes with those of exceptionally healthy people, such as 935 elderly athletes at last year's Huntsman Senior Games in Utah.

Certain farsighted drugmakers have also mounted deep-pocketed efforts to develop tailored medicine. Abbott Laboratories, Johnson & Johnson, and Switzerland's Roche Holding are learning how to examine tissue samples or blood from a patient and spot relevant genetic and biochemical variations, of-

ROCHE'S VON PRONDZYNSKI PLANS AN ARRAY OF DNA TESTS IN THE NEXT FEW YEARS

ten referred to as biomarkers. Pfizer Inc. and Bristol-Myers Squibb Co., among others, are using these tools to fashion pharmaceuticals for targeted groups.

There have been a few early triumphs. One of Genentech Inc.'s most lucrative drugs is Herceptin, which has been used to treat 175,000 metastatic breast cancer patients who share a particular genetic variation. Doctors have also grasped how genes regulate liver enzymes that break down drugs, thus helping to avoid adverse side effects in some patients.

Such success stories are still rare. Personalized medicine resembles a weather forecast, based on probabilities and interpretations of data. The presence of a single gene or combination of genes makes it likely that a person will develop or avoid a particular disease—but the outcome is almost never certain. DNA, RNA, proteins, and chemical signals among cells all play a role in diseases, as do higher-level structures such as the human immune system. And most of these complex interactions are still only dimly understood. Kane predicts that by the time he has reviewed the entire genome, he'll have fingered 40 to 100 different biomarkers in heart disease alone. Says Roche CEO Franz B. Humer: "In 20 years' time, when people look back, they will consider us now as if we were in the Dark Ages."

Not only is the field still immature but it is also beset with concerns about public policy and privacy. Experts fear individuals may be denied life insurance, health insurance, or even a job if they're known to harbor genes for a debilitating illness. Also, there is a debate about whether personalized medicine will reduce or increase health-care spending. Better diagnostics would let doctors intervene more quickly, avoiding some costly procedures. But hospitals may also order more and more tests indiscriminately to cover themselves against possible lawsuits for not detecting diseases before it's too late. And those tests can be expensive: A test for abnormalities on the BRCA1/2 genes implicated in certain breast and ovarian cancers costs $3,000 apiece.

Advocates counter that if the money saves lives, it will be well spent. But the point is far from resolved—and it's just one of many debates about costs, benefits, and timetables. Amid all the contention, doctors, drug-company execs, and patients continue to march forward, drawing on the resources of the world's top academic institutions, hospitals, and government agencies.

While cancer treatments are in the vanguard, heart disease looks as if it might be next. Scientific progress in this area may not help Kane solve the mystery of his own father's unexpected death. But Kane and Malloy have three grown children. If there are markers lurking in their DNA, his work could suggest new courses of action. It also could help millions of others at risk of dying before their time. In this fashion, one research effort at a time, the revolution in personalized medicine is moving forward. Here are some dispatches from the front lines:

The Chief Executive

A TRAINED MATHEMATICIAN, Heino von Prondzynski, the 55-year-old CEO of Roche's diagnostics unit, seems more like a schoolmaster than a crusader. But get him going on the power of diagnostics to transform medicine, and the usually taciturn German exudes an almost missionary zeal. Taking a small silicon chip from his breast pocket, von Prondzynski

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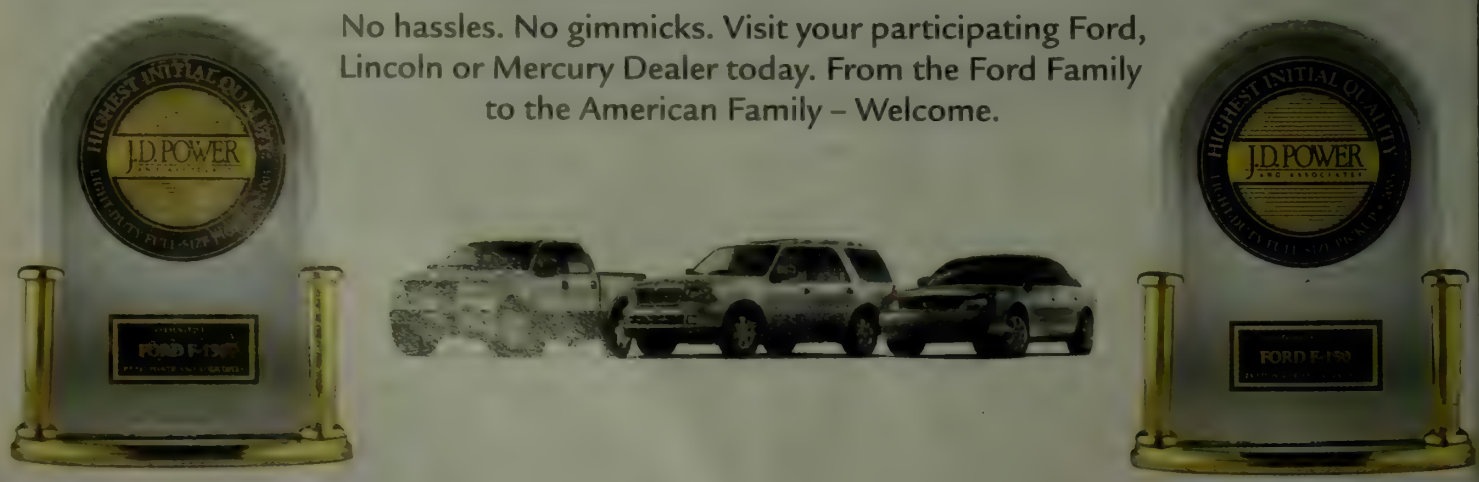

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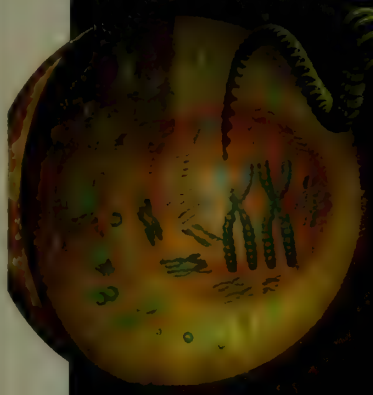
Mining DNA for Biomarkers

Inside the nucleus of each human cell are 23 pairs of chromosomes—long, entwined strands of DNA containing some 25,000 genes that carry the code for everything from the color of your eyes to your predisposition to certain illnesses. These genes contain precious diagnostic clues, which doctors can exploit to personalize medical care:

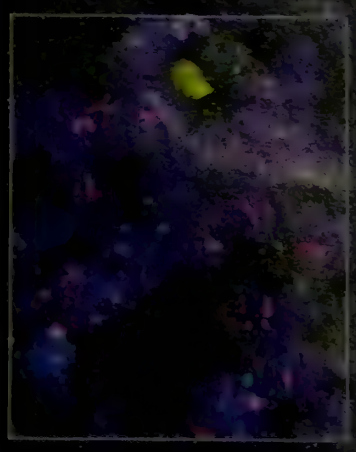


CELL NUCLEUS

GENES ARE NOT destiny. Your medical well-being involves a delicate interplay among DNA, environmental assaults, and other factors. But scientists have identified genetic variations, or "biomarkers," that indicate vulnerability to cancer, Alzheimer's, heart disease, or other ailments.

DNA

ONE OF THE FIRST and most useful biomarkers found is the HER2 gene. When there are too many copies of this gene in breast cancer cells, tumors grow at a deadly pace. This abnormality is thus a marker for malignancy—and also an indicator that the patient might be helped by Genentech's cancer drug Herceptin.



TO SEE IF a woman carries the abnormality, doctors take a biopsy and study the cells using a technique called fluorescence in situ hybridization (FISH), made by Abbott Laboratories. In the test, the DNA is painted with fluorescent molecules, which attach to copies of the HER2 genes and light up (left). A computerized scanner then determines if the count is abnormally high.

claims the device—no bigger than a postage stamp—and others like it will lay the foundation for a new era of health treatment, enabling earlier and more accurate diagnosis and more customized care.

Launched in the U.S. in January, Roche's device—called the AmpliChip—is the first genetic test approved by the Food & Drug Administration to identify responses to a wide array of medications. It does this by detecting genetic variations that control two liver enzymes responsible for how patients metabolize up to 25% of prescription drugs. For some people known as ultra-rapid metabolizers, there are too many such enzymes in the bloodstream. That causes the body to clear the drugs out of the system so fast they get no benefit. About 3% to 10% of people lack the enzymes altogether and cannot break down medication, so the drugs build up too quickly in the bloodstream, making even a standard dose toxic. Devices like the AmpliChip, says von Prondzynski, "will address the two biggest challenges facing the health-care system today: cost and safety."

That could save society enormous sums. Each year 2.2 million Americans suffer adverse reactions to prescription drugs. Of them, more than 100,000 die, making side effects a leading cause of death. Often blockbusters like Vioxx are found to be the culprits. The cost of treating adverse drug reactions in the U.S. alone totals $4 billion annually, according to a *Journal of the American Medical Association* study. All told, Roche estimates that the U.S. could shave $21 billion from its health-care bill by 2020 if doctors used tests such as AmpliChip to select the right medicine at the right dose, based on a patient's genetic makeup.

The payoff for Roche could be huge. Swiss consultancy Jain PharmaBiotech estimates that Roche's sales of molecular diagnostic kits and devices could grow from $6.5 billion a year now to $12 billion by 2010. Today such gene-based tests are a small part of Roche's diagnostics sales, which made up more than 25% of the company's $23 billion sales for 2004. But gene tests are growing the fastest by far.

Roche got a head start in molecular diagnostics. Against the advice of its own scientific advisers, the company laid out $300 million in 1991 for the rights to a tool called polymerase chain reaction from Cetus Corp. in Emeryville, Calif. Invented in the early 1980s by Cetus scientist Kary B. Mullis, PCR was then a largely untested technology that allowed traces of genetic material to be amplified for analysis. Few at the time thought it had much commercial potential. But the doubters were wrong. In 1993, Mullis was awarded the Nobel Prize in chemistry, and Roche has gone on to use PCR as the foundation of cutting-edge diagnostic tests to detect everything from hepatitis and HIV to cancer.

Von Prondzynski believes a series of new cancer diagnostics will further improve treatments. In 2006 the company plans to launch a DNA chip to pick up the p53 gene. In healthy people, p53 plays a role in suppressing tumors, and many people who harbor variations of it wind up with cancer. Roche's chip not only catches the variations but also is designed to show how fast or slowly a tumor is likely to grow, enabling doctors to decide how aggressively the cancer needs to be treated. By 2008, Roche hopes to have a test available to predict the likelihood of relapse in patients with colorectal cancer. The following year it plans to field screening tests for early signs of breast, prostate, and colorectal cancers. "In 10 years' time," says von Prondzynski, "I could envision having three DNA chips for breast cancer alone: One for early detection, one for drug selection, and another for therapy monitoring."

"I LOST 10 YEARS OF MY LIFE" FROM UNSUITABLE MEDICATIONS, SAYS WESTRA

The Patient

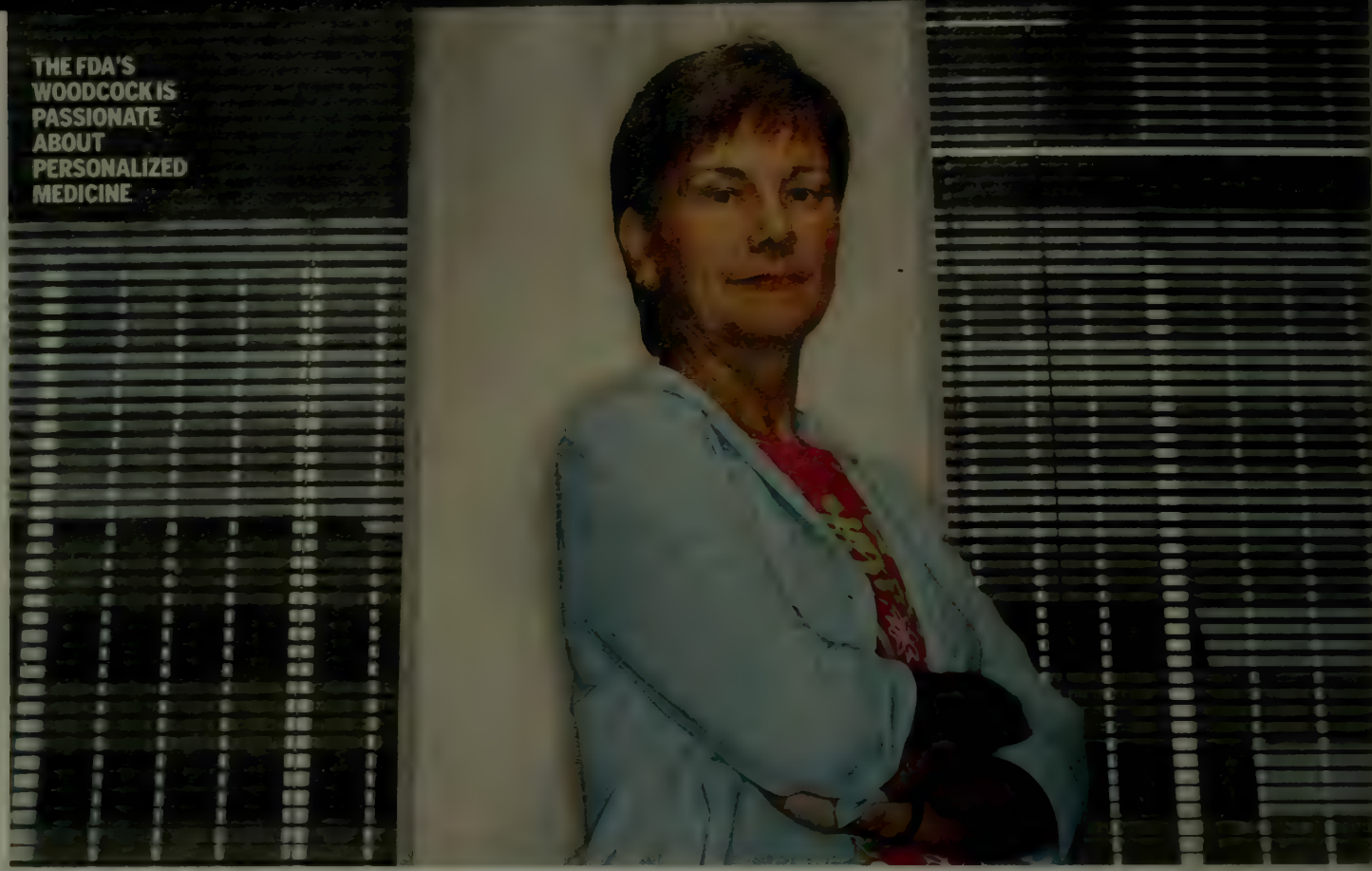
ANNEKE WESTRA HAS EXPERIENCED the power of Roche's diagnostic technology. Eleven years ago, at 30, she was a promising scientist with a PhD in biotechnology who already had a patent to her name. Despite a lifelong struggle with depression, she became an expert in biosensors, traveling the world to present scientific papers. That changed in September, 1994, when the Londoner was diagnosed with bipolar disorder.

It was the start of a decade-long debacle. Westra's treatment involved a dozen psychiatrists and 18 pharmaceuticals—each drug, it seemed, with worse side effects than the one before. Her mental and physical health deteriorated. Frequently hospitalized and unable to work, she eventually tried to kill herself. "I lost 10 years of my life from the drugs I was given," she says.

Westra's case is extreme but not unique, and it explains why doctors and patients both are eager for personalized medicine. One in five people at some point suffer depression severe enough for medication. Many spend months trying a variety of drugs, at different dosages, before hitting on a prescription that works—if they're lucky. For 25% of patients, the most common antidepressants—selective serotonin reuptake inhibitors such as Prozac—are ineffective. Millions more are wracked by side effects. Until Roche launched its AmpliChip, there was no reliable means of monitoring the family of enzymes found mainly in the liver, known as CYP450, that dictate how our bodies break down medication. That left trial and error—and a trail of tears.

MORE THAN 100,000 PEOPLE DIE FROM DRUG SIDE EFFECTS EACH YEAR

After her diagnosis, Westra spent the next few years in and out of the hospital, but no matter what drugs doctors prescribed, terrible side effects set in almost immediately. Promazine knocked her unconscious for five days, while within four days of taking Eli Lilly's Zyprexa she was hearing voices in a drug-induced state of psychosis. "No one believed



THE FDA'S WOODCOCK IS PASSIONATE ABOUT PERSONALIZED MEDICINE

me when I told them I was being poisoned by the drugs," she says.

Finally she found a psychiatrist who prescribed a mild tranquilizer, and she improved. Rested and thinking clearly for the first time in years, Westra deduced that her troubles had something to do with the way her body metabolized medication. In just three hours of exploring medical Web sites, "I worked out what it might be," she recalls. "I was crying with relief."

Her research led her to Dr. Katherine J. Aitchison at the Institute of Psychiatry at King's College London, who confirmed Westra's suspicions. Using the AmpliChip test, Aitchison found Westra had too little of two drug-metabolizing enzymes in her liver, making her acutely sensitive to numerous medications.

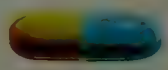
Millions of people may be like Westra, according to Dr. José de León, an associate professor of psychiatry at the University of Kentucky and medical director of the mental health research center at Eastern State Hospital in Lexington. In a study published in the January issue of *The Journal of Clinical Psychiatry*, de León found that patients without the CYP2D6 enzyme—one that Westra had too little of—were three to six times more likely to experience severe side effects when placed on the antipsychotic risperidone. Now he's conducting a study on 4,000 psychiatric patients at three state hospitals in Kentucky to determine if testing patients for these genetic variations before prescribing is cost-effective.

Westra, 41, finally has her life back. She takes minuscule amounts of three psychiatric drugs, and uses homeopathic remedies. "I used to fall into a a suicidal depression that would last nine months. Now the depression lifts in two weeks. That never happened before." In addition to advising mental health practitioners, she's the co-founder of Britain's No Force Campaign, which lobbies against forced medication of the mentally ill. And while she has testified calmly before Parliament on the topic, she's still angry at the health-care system that let her down. "I have been through a nightmar only to discover it never should have happened," she say "The information was out there."

The Regulator

FOUR YEARS AGO top FDA official Dr. Janet Woodcock m with drug industry representatives to discuss the promise personalized medicine. "It was a 'call to light' kind of mee ing," recalls Woodcock, now deputy commissioner. But th pharmaceutical folks weren't ready to sign on. "People stoc up and said: 'We are terrified.'"

Their reaction wasn't surprising. Using drugs in targete ways raises scientific, financial, and regulatory issues. F companies, it can mean smaller markets for drugs and th risk that they will not win FDA approvals unless they ca



YOUR ENZYME PROFILE MAY ONE DAY BE CHECKED INSTEAD OF YOUR CHOLESTEROL

prove that the target is proper, as well as the drug.

Faced with such concerns, Woodcock is a passionate advocate: She has a vision of the FDA working with scientists and companies to bring better drugs to market faster, and to use existing drugs only for those patients who will benefit from them. The vision is fueled by fresh evidence that patients' varying response to drugs are hardwired in their DNA. Recently, researchers have found variations in two genes that predict how much blood thinning will occur with a given dose of warfarin. Testing for those variations, then adjusting the starting dose accordingly, could be a huge medical advance—preventing cases of bleeding from too much of the drug or clots from too little. "It isn't that there are bad drugs and good drugs," she says. "It's that some drugs run into bad problems with a small subset of people."

In addition, the medical community is becoming accustomed to the idea of pairing diagnostics and drugs, especially when introducing new treatments. For a cancer drug that has only a 10% response rate in the general population, "we can make it a 100% response if we can figure out who actually benefits," says Woodcock. "Then the other 90% don't have to be exposed to the drug, and everyone is happy." That should also mean fewer Vioxx-like debacles, and fewer crippling liability payouts.

There's also the hope that developing drugs and diagnostics together will simplify FDA approval. By focusing clinical trials more tightly on people who are likely to benefit, the trials could be smaller, they would take less time, and so would the approval process. And by weeding out potential victims of side effects at the trial stage, companies would stand a better chance of getting their products greenlighted.

More You Should Know about Medical Breakthroughs

Life or Death: Cutting-edge diagnostics will help make that difference for patients, says leukemia pioneer Dr. Torsten Haferlach

Is Genetic Testing Cost-Effective? One researcher sets out to prove the benefits for patients and health-care systems

Beating Breast Cancer: Herceptin—the first drug approved for a specific population—is helping women survive a virulent form of the disease

Advice from the FDA: Deputy Commissioner Dr. Janet Woodcock goes into more detail about how to avoid Vioxx-like problems

BusinessWeek online

www.businessweek.com/extras

That's the rosy scenario, anyway. The darker view is that companies will discover that it's expensive—and scientifically challenging—to identify biomarkers that predict a patient's response and then to develop the necessary diagnostic tests. Once the tests are available, skeptics contend, doctors still may not use them before prescribing. And because the FDA has no authority over the practice of medicine, it can't insist.

The agency can issue stern warnings, but experience is not reassuring. When the diabetes drug Rezulin started causing liver failure in some patients, the FDA ordered doctors to monitor patients' liver enzymes to spot early warning signs. Yet few did. Patients continued to die, and the agency had to withdraw the drug from the market.

What's more, as companies probe the genetic impact of powerful new drugs, they may be in for unpleasant surprises. What if, for instance, a drug that seems to cause no side effects happens to turn on a gene linked to cancer or to liver repair? Would the FDA then demand years of testing to show that the drug doesn't cause cancer or harm the liver?

Since her meeting with pharmaceutical executives four years ago, Woodcock and her team at the FDA have worked hard to assure drugmakers that they won't be penalized for doing these so-called pharmacogenetic studies. The agency has ruled that disclosing genetic data is voluntary, not mandatory. And it has created a "safe harbor" for companies to discuss findings with FDA experts without triggering regulatory issues or delays.

"I give Janet a lot of credit for continuing to pound on this," says Mikhail L. Gishizky, chief scientific officer at drug researcher Entelos Inc. in Foster City, Calif. And her efforts are slowly having an impact. "We are seeing companies moving this technology into the clinic in the next year or so," says Woodcock. So tomorrow's drugs should come with a far better understanding of how they should be used and in which groups of people. "It is a big scientific endeavor," she says. "But the payoff is so tremendous that it must be accomplished."

When doctors, drugmakers, patients, and regulators all push in the same direction, few barriers are likely to stand in the way. ■

HOMING IN on Cancer

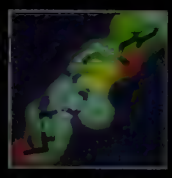
Most blockbuster drugs are prescribed too broadly, failing to help some patients and harming others. But in oncology, doctors now pair diagnostics with drugs to find the patients most likely to benefit. Such personalized pharmaceuticals include:

HERCEPTIN (Genentech): Aimed at women with late-stage breast cancer whose genes carry the HER2 biomarker. On the market since 1998

GLEEVEC (Novartis): Targets a cancer-related protein called BCR-ABL in patients with chronic myelogenous leukemia. On the market since 2003

SUTENT (Pfizer): For people with Gleevec-resistant gastrointestinal tumors bearing special cell markers. Late-stage human trials were completed in May

ENZASTAURIN (Eli Lilly): Aimed at patients with aggressive brain tumors that bear particular markers. Late-stage human trials will begin in early 2006



DASATINIB (Bristol-Myers Squibb): Could benefit leukemia patients with the "Philadelphia chromosome," which makes them resistant to Gleevec. In mid-stage human trials

CP-751,871 (Pfizer): Aimed at patients suffering from bone-marrow cancer whose genes carry a biomarker for an insulin-like growth factor. Now in early clinical trials

ABT-737 (Abbott Labs): This drug targets a certain strain of lung cancer and lymphoma cells, reactivating a switch that allows these cells to die. In animal experiments.

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INNOVATIONS

Tropical warming and harmful gases

>> Environmentalists have long believed the most serious effects of global warming would be felt at high latitudes, where melting ice caps have already set off alarms. But now, University of Washington scientists believe the tropics may be in even more peril. In a study presented on Aug. 19, the researchers found that organisms in the steamy tropics have little tolerance for even tiny temperature shifts. That's because they haven't experienced normal seasonal swings allowing creatures in places such as Alaska to adapt to

temperature changes. The research could shed light on which organisms are in danger of extinction.

>> A study released on Aug. 9 shows that some ecosystems cannot absorb as much carbon as scientists once believed they could. Jeffrey Dukes, a biologist at the University of Massachusetts, led a study exposing grasslands in California to excess CO_2 and other global-warming conditions. The grasslands did not store much of the excess. Dukes hopes to study other ecosystems to better understand why some don't act as a buffer against global warming.

FIBER Tubes being teased into fabric

NANOTECHNOLOGY

SPINNING AND WEAVING NEW USES FOR NANOTUBES

CARBON NANOTUBES (CNTs) have long held great promise as building blocks for next-generation materials and electronic devices. Lighter and stronger than steel, CNTs can also conduct electricity well. But efforts to combine them into usable structures haven't yielded much success to date. In the Aug. 19 issue of *Science*, however, scientists in Texas and Australia outline a new method to spin CNTs into thin sheets.

To make the sheets, trillions of individual CNTs—chemically grown in forest-like clumps—are teased together to create larger ropes, which in turn are merged into fabric strips. The resulting ultralight material—an acre's worth would weigh as little as 4 oz.—has potential uses in everything from space sails to light-emitting displays, and artificial muscles to transparent radio antennas, says Ray H. Baughman, the University of Texas at Dallas nanotechnologist who led the project. Prototype products using the fabric, he adds, could be available in 2006. *–Rod Kurtz*

DIAGNOSTICS

A DIFFERENT KIND OF WET CELL

HUMANS HAVE been exploiting the power of urine for centuries. The Romans brushed their teeth with it. Other cultures, such as the ancient Chinese, drank it to purify the body of all manner of ills. Now scientists in Singapore have devised a pee-powered battery to run tiny, portable test-kits for diseases such as diabetes.

The kits work thanks to a tiny chip made of copper, magnesium, and paper laced with copper chloride. A drop of urine on the credit-card-sized device starts a chemical reaction that causes a tiny electrical current—enough to test the sample for diseases.

Dr. Ki Bang Lee, who led the research at Singapore's Institute of Bioengineering & Nanotechnology, is now working on chips powered by other bodily fluids. Lee figures cheap, disposable tests could help patients in underdeveloped countries to monitor their own minor health conditions. He also believes his invention could run a range of gizmos, including a saliva-powered emergency cell-phone. One lick may provide enough juice to make that vital call.

–Constance Faivre d'Arcier

HEART DISEASE

HOW IT CAN MAKE YOU DEPRESSED

PEOPLE WITH heart failure often suffer from the blues. Now scientists may have proof that it's not just the energy-sapping symptoms of their disease that makes heart patients feel down. On Aug. 19 researchers at the University of California at Los Angeles published a study linking heart disease to a form of brain damage that can cause depression.

MRI scans taken of patients with heart failure revealed tissue loss in the part of the brain that regulates the autonomic nervous system. That's the same region of the brain that exhibits changes in patients suffering from depression. The researchers, who published their findings in the *Journal of Cardiac Failure*, believe the brain damage also impedes blood-pressure regulation, making it uncomfortable for heart patients to exercise—a key part of their recovery.

The findings may inspire drugmakers to search for heart-disease remedies able to cross the blood-brain barrier and prevent tissue injury. "Neuroprotection is the magic key," says Ronald M. Harper, professor of neurobiology at UCLA.

FEELING BLUE

Chuck Prince's Citi Planning

The CEO has a strategy for the financial giant. Those who don't like it can quit

AFTER THREE YEARS OF grappling with angry regulators, sagging morale, stumbling financial results, and a stock stuck in neutral, Citigroup chief executive Charles O. Prince is ready to roll. He's revving up the world's largest financial company with a new growth plan.

The recent spate of high-level departures is a sign of the changing times. Prince is populating the bank's upper echelons with what he calls the "next generation of leaders," people ready to implement his vision for Citi. Now out of the long shadow cast by his predecessor, Sanford I. Weill, Prince is clearly moving away from a strategy that relied heavily on huge acquisitions for growth.

In an interview with *BusinessWeek*, Prince says he has renounced big deals until at least the end of next year or early 2007—a full year after the Federal Reserve's ban on Citi making any major acquisitions was expected to end. "I think that people have concerns that we are going to be forced to do a big deal and have all kinds of acquisition risk," he says. "If we can go as little as five or six quarters consecutively without headline issues, with good solid organic growth without having to do a big complicated deal, [then] we will see an important change in the sentiment about the stock." Citi shares are down 10.6% so far this year.

MARJORIE MAGNER

Citi's head of consumer banking left when Prince opted to split her fiefdom

Prince's new growth strategy has four prongs: Invest heavily in the consumer businesses, capitalize on fast-growing international markets, build up the corporate investment bank, and restore Citi's battered reputation. "Everything we do should fit under one of those headings," he said.

The key to making Prince's plan work is restructuring consumer banking, Citi's most valuable real estate. Last year, it generated $47 billion in revenues and $12 billion in earnings, or about 55% of the bank's profits and more than either Wal-Mart Inc. or Microsoft. Yet its credit cards are losing market share, and consumer finance is lagging behind peers. Citi has about a third as many branches as Bank of America Corp., which is running a much smoother retail business.

As Prince sees it, Citi needs to reorganize the company from selling just products, and focus more on service, as do BofA and fast-growing upstarts such as Commerce Bancorp Inc. of Cherry Hill, N.J. He says he'll spend big to develop Citi's brands by upping advertising budgets and by launching a richer rewards program so that the more Citi products customers use, the greater discounts or perks they get. And he'll also build branches from scratc though acquisitions of small banks a also likely. Citi has only a 3.6% share U.S. deposits, while BofA's 10% is at Fed-imposed ceiling.

FOREIGN APPROACH

HIS PLAN TO overhaul consumer banl ing put Prince on a collision course wit Marjorie Magner, a 20-year vet of th bank, who announced on Aug. 23 th she would resign as head of the glob consumer group and leave. Prince splitting her bailiwick in two. He pr moted longtimers Ajay Banga, 45, an Steven Freiberg, 48, as co-heads of th consumer group. Banga, president of r tail banking, will oversee North Americ Freiberg, CEO of Citi Cards, will run th group's international operations. Ma ner didn't respond to several reques for comment.

In Prince's view, foreign markets wit plenty of growth potential need a diffe ent approach than mature U.S. and Can da markets. His top priorities are to inve more in retail banking in emerging ma kets like Poland, Turkey, and India, least double Citi's credit-card volu worldwide, mostly in Southeast Asia an

MAKING HIS MARK Prince has—for now—forsaken Weill's policy of growth-by-merger

atin America, and sell more investment roducts in Europe.

Prince is also busy streamlining the prawling Citi empire. In recent months e has cut six operating units to four and old off Citi's asset management and ravelers insurance units. To expedite rategic decisions he has created a 30-erson operating com-ittee, half the size of he management com-ittee he inherited from Veill. And he's overhaul-ng Citi's investment ank. Prince has made hree acquisitions for ndisclosed sums to beef p electronic trading or institutional clients, uilt a new distressed-ebt group, and given quity and derivatives ading new technology nd manpower.

Meantime, the clean-p of Citi's past trans-ressions continues. In une, the bank agreed to ay a total of more than 2.2 billion to settle alle-gations that it had overcharged mutual fund investors discounted fees, as well as a class action over its lending to Enron. Prince's campaign to improve the bank's "values, priorities, and internal controls" in order to wipe out any holdover rogue instincts from the old Citi culture is in full swing.

Prince's Plan

Slow growth in Citigroup's U.S. consumer business as well as regulatory and other problems have hurt earnings and the stock price. Here's how CEO Chuck Prince aims to fix them:

FORGO big mergers for at least 18 months to gain the market's trust.

EXPAND credit cards and retail banking in high-potential emerging markets such as Poland, Taiwan, Indonesia, and Russia.

GIVE U.S. customers incentives to use more bank products by offering rewards and discounts. Open more branches.

SPLIT global consumer banking in two to separate mature domestic markets from fast-growing foreign ones.

BUILD UP the investment bank by adding electronic and derivatives trading and adding a distressed-debt team. Beef up staff in Europe and Asia to cater to hedge funds.

PUSH a five-point ethics plan, introduced in March, to clean up Citi's culture.

Some like what they see so far. "[Prince] is not making foolish acquisitions, and he seems to be very genuine about meeting the commitments he has to the Street," says James K. Schmidt, co-manager of the $2.3 billion John Hancock Regional Bank Fund, which owns 1.3 million Citi shares.

Still, the recent hemorrhaging of top executives has made some on Wall Street nervous. In mid-July, Citi's No. 2, Robert Willumstad, resigned after 20 years at the bank. Even Weill got into an embarrassing imbroglio with Citi's board over an apparent effort to quit as chairman before next April's annual meeting as planned. He was mulling leaving earlier to launch a $5 billion private-equity fund. "Many of the original visionaries of Citi as we know it today are leaving," says research analyst David Hendler of CreditSights. "There was never any indication that these people were unhappy."

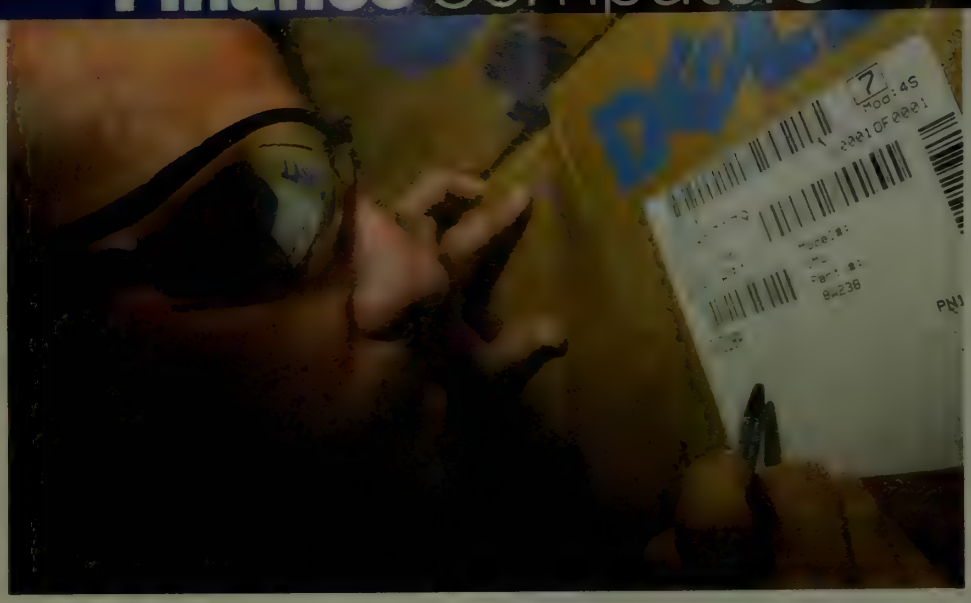
ONE-STOP SHOPPING

Prince insists that the management changes are not part of an orchestrated plot to oust the Weill regime. "There is kind of a natural evolutionary process where at some point if people have been here a long time, they go off and do something else," he says. "That's healthy for an organization."

Despite Prince's ambitious plans for the bank, he still believes in the concept of a one-stop-shopping bank that Weill pioneered. While the debate over the viability of that model rages on, Eugene Ludwig, a former comptroller of the currency, says there's more of a case for it than against. "It's hard to argue with the power and diversity of the Citi or JPMorgan Chase or BofA balance sheet," he says. "You can make a lot of mistakes when you have that kind of powerful capital base behind you."

Since he became CEO, Prince has had Citi's huge clout at his disposal. But he has been too preoccupied with crisis management to use it. As those problems begin to ebb, the market is eager to see how well he can deploy Citi's power now that he's his own man. ■

–By Mara Der Hovanesian in New York



What's Dogging Dell's Stock

Worries over growth are holding down its shares while those of rival HP take off

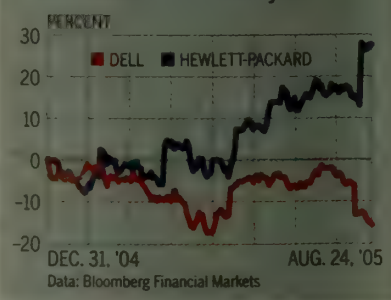
FEW INVESTORS WOULD dispute the notion that Dell Inc. is one of the great companies in tech. The world's largest computer maker's earnings jumped more than 25% last year, outpacing a nearly 19% rise in sales. It has a clear playbook to push into higher-margin products and new geographic markets. So why are Dell shares down 16% since the end of last year, while those of rival Hewlett-Packard Co. have soared more than 27%?

HP is simply beating Dell hands down in managing Wall Street's expectations. HP was long one of tech's most mediocre performers—famous for big earnings disappointments and unfulfilled ambitions. But the stock lost its "Carly discount" after the divisive Carleton S. Fiorina was shown the door in April, and the new chief executive, Mark Hurd, began doing the right things. He has attacked bloated costs and brought in new management blood. Analysts expect the no-nonsense Hurd, known for underpromising and overdelivering on results, to boost already-rising earnings through nuts-and-bolts operating improvements such as more disciplined pricing. Says Merrill Lynch & Co. analyst Richard Farmer, "We think Wall Street is still underestimating HP's earnings power."

By contrast, Dell is becoming a victim of its own success. On Aug. 11 the company announced a second-quarter sales increase of 14.7%, far outpacing HP's 10% rise. The Round Rock (Tex.)-based Dell said it cut prices too much and didn't sell as much as it hoped to the federal government. Trouble is, the sales number was below its own earlier forecast of a 16% to 18% increase. Worse yet, Dell also ratcheted down its revenue projections for the current quarter ending in October. Dell's stock immediately tanked 7.4%. Some analysts are questioning whether Dell stock still deserves its longstanding premium rating. On Aug. 12, high-profile Goldman Sachs & Co. analyst Lau Conigliaro downgrad ed Dell to "market pe form" from "outpe form" because of th lower estimate for future sales growth.

LEFT IN THE DUST

Dell's stock price has trailed far behind HP's this year



Data: Bloomberg Financial Markets

SHIPPING OUT Dell says it cut prices too deeply

Until this year, Dell gave specific guid ance for sales and earnings. But in th first quarter, the company began giving range instead. Dell spokesman Je Blackburn explains that as the compar gets bigger and more global, "being ab to predict a precise outcome for a quart does become more challenging." Som investors aren't happy with the chang especially when Dell misses the targ range. "Management has been leadin investors in somewhat of a whipsaw says Tony Ursillo, an analyst at mutu fund group Loomis, Sayles & Co., whic owns about 2.8 million Dell shares. "Ha Dell come out at the beginning of th year and said it would achieve a 15 growth rate, the stock wouldn't hav been so volatile."

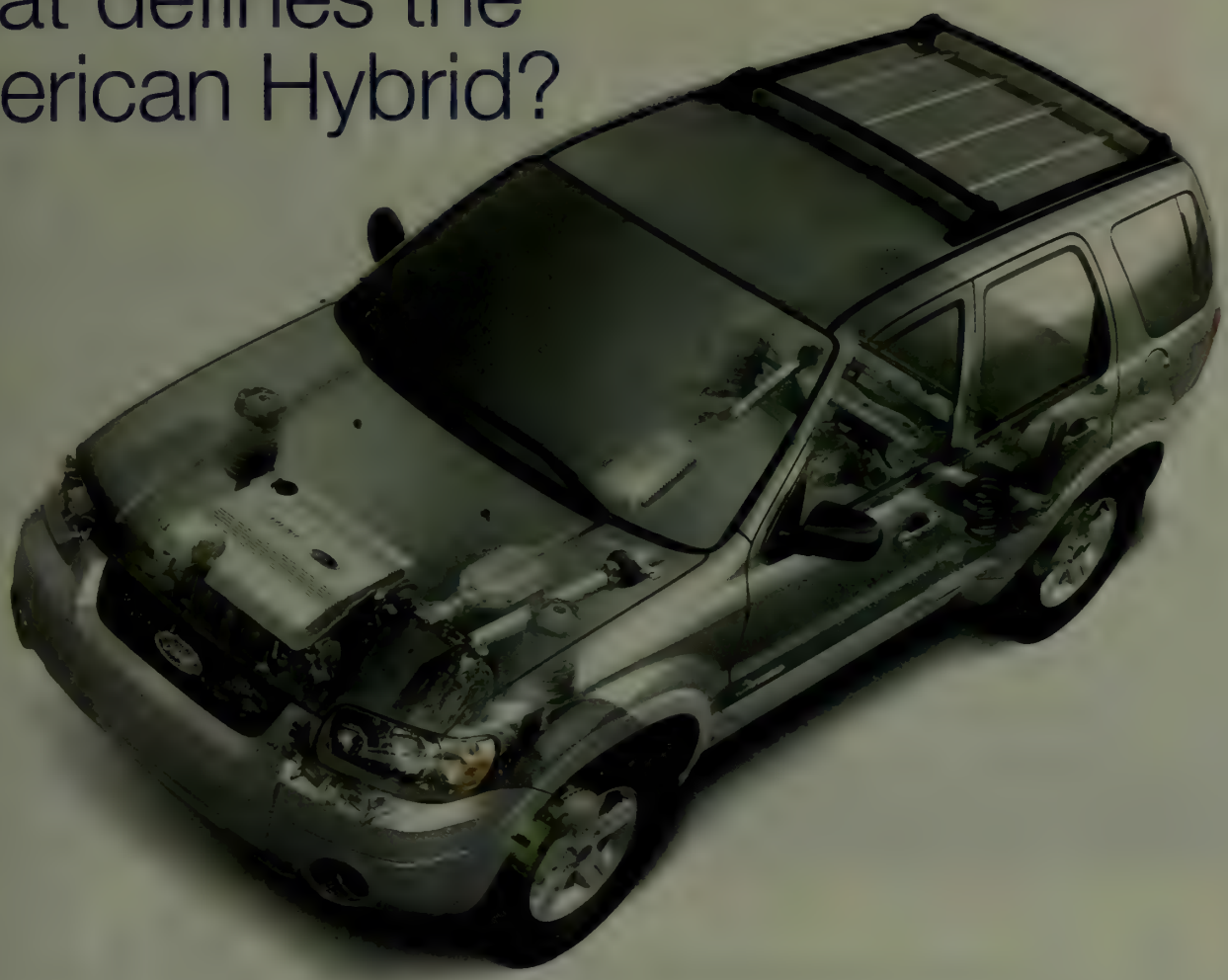
NEW PRODUCTS

ASIDE FROM the problem of Dell missin its own expectations, analysts figure th company's revenue growth is unlikely t get back to the 17% to 18% pace it wa posting a year ago. That's because abou 79% of Dell's $49 billion in sales la year came from desktops and noteboo computers, both categories in whic prices are falling. While analysts gene ally applaud Dell's expansion int higher-margin products such as mus players and flat-screen TVs, "its entr into consumer electronics is seen a evidence that the core businesses ar maturing and that doesn't deserve a pre mium stock value, says Richard Chu, an lyst at SG Cowen & C

That leaves Dell in vestors still scratchin their heads, wonde ing whether there another revenue shor fall in the cards. Ch says Dell's trouble this year "creat questions not abou whether this is a ba team, but whether good team is missing because the gam is getting tougher." If that's happenin investors may just have to lower the expectations about Dell's earnings—an its stock. ■

–By Louise Lee with Peter Burrows i San Mateo, Cali

What defines the American Hybrid?



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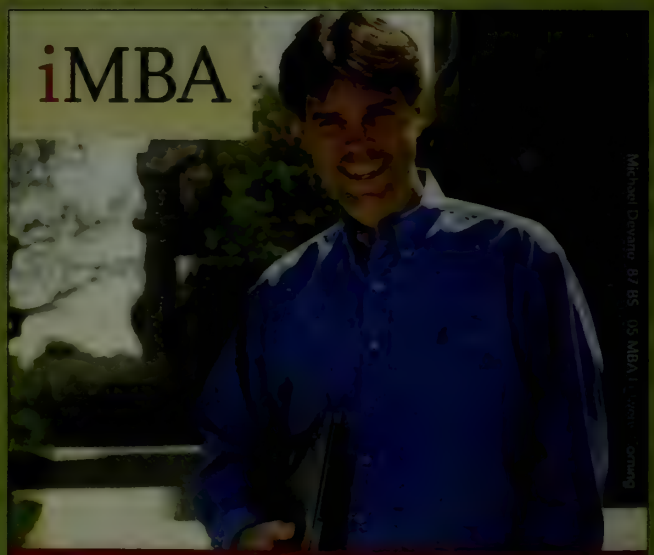

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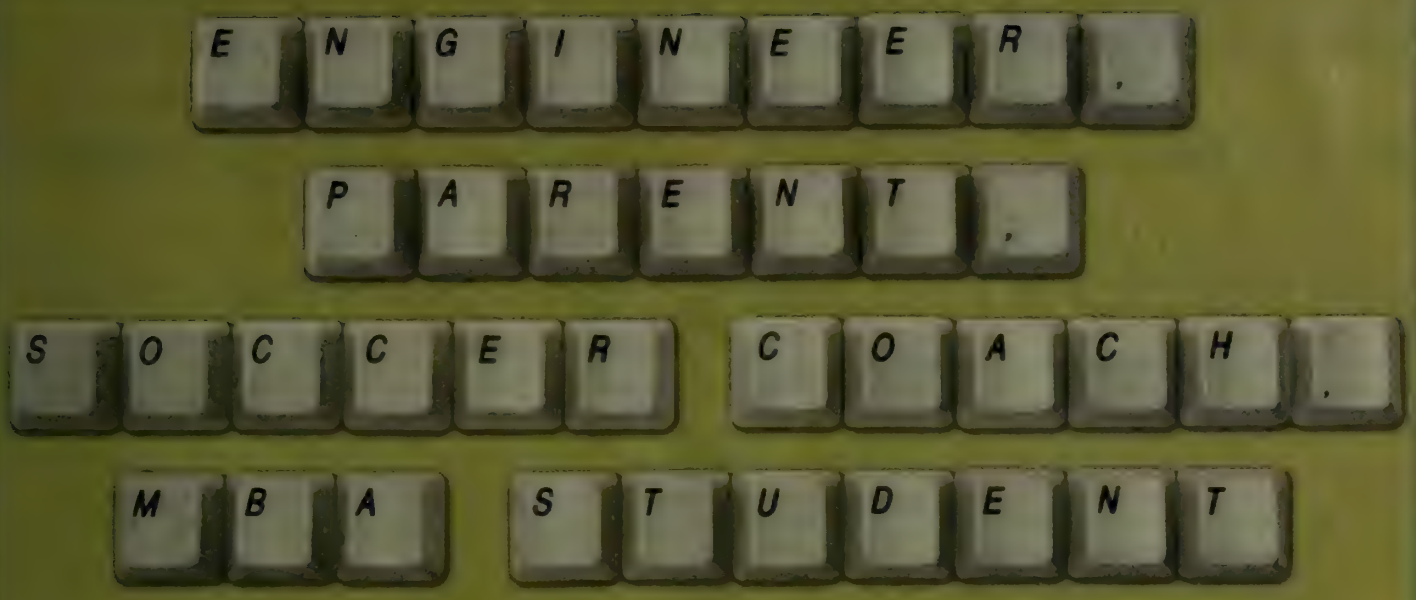

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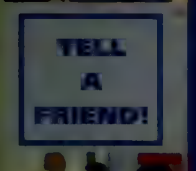

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Slow to Reveal The Deals

Many brokers don't say much about payments they get to push certain mutual funds. **BY ANNE TERGESEN**

YOU MIGHT HAVE THOUGHT the mutual-fund scandals put an end to pay-to-play arrangements. But the practice of fund companies paying extra to give brokerage firms an incentive to push their funds or hand them coveted spots on "preferred lists" remains firmly entrenched. Brokerages like these arrangements, which bring in an estimated $2 billion in annual revenue on top of regular commissions, according to Boston consulting firm Financial Research Corp. Fund companies depend on them to gain an edge in a universe of more than 6,400 offerings.

Now, many from both sides are finally starting to say more about these "revenue sharing" deals. But the Securities & Exchange Commission's disclosure rules are minimal—the only time a brokerage firm must tell you it received revenue sharing from a fund sponsor is when you purchase shares, although a proposed rule could make them stricter. So for now, there's wide variation in how much detail the firms give out, and no two firms do it the same way. This makes it more difficult for investors to track down the information than to find, say, the sales charges and management fees that are laid out in uniform tables in the fund prospectus.

Since fund companies pay for preferred positions out of their own pockets, why should you care? Because you want to be sure that the fund you're buying is the best fund for you, not because it's the best one for the broker to sell.

Revenue-sharing arrangements vary from broker to broker. Though firms often receive higher payments from some fund groups than from others, they rarely say who pays the most. One exception is Smith Barney, which on its Web site, smithbarney.com, ranks the fund families from those that paid it the most in 2004 (Smith Barney and Franklin Templeton) to the least (Legg Mason and Nations).

At the other extreme are firms whose disclosure is bare-bones. A.G. Edwards acknowledges in a statement prepared for *BusinessWeek* that it receives payments from "some—not all—of the mutual-fund companies." But it does not disclose them, it says, because "these agreements have not influenced the fund recommendations we make." Indeed, as long as a fund's prospectus reveals that the fund's sponsor pays revenue sharing—and gives some indication of the amount—a brokerage firm can substitute that prospectus for its own disclosure, says Douglas Scheidt, chief counsel for the SEC's Investment Management Division.

CHECK THE WEB

THE PROSPECTUS and the more detailed statement of additional information (SAI)—available upon request and at many fund company Web sites—don't usually say how much goes to specific brokerage firms. The Jan. 29 SAI for Fidelity Advisor Equity Growth Fund only says that Fidelity Investments anticipates paying "hundreds" of firms amounts that depend, in part, on whether the fund was placed "on a preferred or recommended fund list."

So where can you find out if your brokerage firm gets paid extra by selling you a particular fund? Besides asking your broker, look to the firm's Web site. If you

type "revenue sharing" in the search box at UBS Financial Services' site, ubs.com, you'll get to a page that lists 21 fund companies in the firm's "Tier 1" group. Together these accounted for "approximately 80%" of UBS's 2004 and first-quarter 2005 mutual-fund sales. (The 21 fund families are a fraction of the approximately 300 that sell "load" shares through brokers, according to Financial Research Corp.) UBS acknowledges that revenue sharing is "a factor in determining whether a fund company is placed in Tier 1," but it adds that "such payment is never the sole determinant."

Likewise, Smith Barney's Web site reveals that it allows about 37 favored fund families into its branch offices to promote their funds to brokers. Perhaps as a result these companies comprised "approximately 94.4%" of Smith Barney's 2004 mutual-fund sales. Fund companies "that do not remit revenue-sharing payments typically will not be provided such access," the Web disclosure adds.

Several other firms—including Morgan Stanley, Wachovia, and smaller rivals—also publish, on the Web and in client literature, the names of the fund companies from which they take payments. Merrill Lynch simply says it requires all the fund families it sells—more than 100, according to a spokesman—to make revenue sharing payments, and that it has no preferred list. "Funds that do not enter into arrangements with Merrill Lynch are generally not offered to clients," states a pamphlet sent to new clients that's also available at ml.com.

One thing even the most candid brokerage firms don't reveal is how much revenue sharing money they collect. At best, they'll show their maximum levies. Smith Barney reports on its Web site that it generally charges fund families up to 0.09% annually of the value of the assets its clients hold in bond funds, and up to 0.12% per year of its clients' stock and balanced-fund assets. You can use that information to approximate how much the firm will get from your investment.

Even if your broker offers good disclosure, you may get a better idea of what your fund is paying in the fund's prospectus and SAI. The May 1 SAI for MFS's Massachusetts Investors Trust says MFS generally pays brokerage firms up to 0.10% of the value of their annual sales of the fund, plus up to 0.05% of the annual value of client assets in the fund. MFS also says it may pay up to $20 to offset "ticket charges." These are fees a broker pays the brokerage firm to process fund orders. Like many of its peers, MFS says it may also foot the bill for broker conferences, seminars, training programs, entertainment, and travel. How much does that come to? MFS declines to say.

Sure, brokerage firms and fund companies are disclosing more about their financial dealings. Dig deep enough, though, and you may unearth more questions than answers. ■

What They Disclose

Here's what some of the biggest firms make public on Web sites or in client literature about "revenue sharing" payments that get mutual funds on "preferred" lists:

MERRILL LYNCH

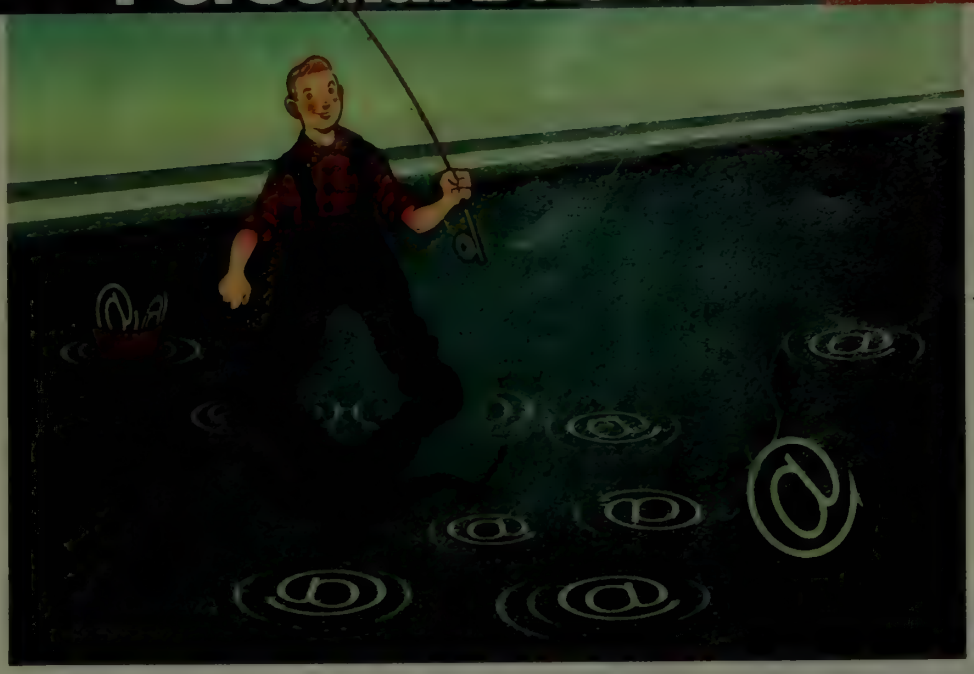
Has selling agreements with about 100 companies, charging them up to 0.25% on a portion of fund sales and up to 0.10% annually on a portion of total fund assets for marketing services. It also charges "load" funds up to either $19 per client per fund or up to 0.13% of fund assets annually for administrative services.

MORGAN STANLEY

Charges each fund company it has a selling agreement with up to 0.20% on purchases and up to 0.05% per year of fund assets held at Morgan Stanley. Also charges up to $19 per fund account annually for administrative services. Lists about 20 fund companies that pay to participate in events that brokers attend.

SMITH BARNEY

Breaks revenue-sharing fund families into two groups—one with access to its network of brokers and one without—and ranks the fund companies based on the total amount of revenue sharing they pay. Generally charges up to a maximum of 0.09% a year on clients' bond fund assets and up to 0.12% a year on stock-and balanced-fund assets.



How the Web 20 Whipped the Street

Out-of-favor companies helped it blow past the S&P 500. **BY TIMOTHY J. MULLANEY**

SINCE WE REVISED THE *BusinessWeek* Web 20 on Apr. 15, our portfolio of blue-chip Net stocks has gained 20%. That's almost triple the 6.9% rise of the Standard & Poor's 500-stock index and eases past the 15% hike in the Amex InteractiveWeek Internet index.

The 3-year-old Web 20 beat the market by holding on to out-of-favor companies. The biggest gain, 58% since April, came from ad agency aQuantive, which we stuck by as it struggled to absorb its 2004 acquisition of Razorfish. This year, Razorfish's creative savvy added to aQuantive's media buying and technological prowess grabbed more business from two dozen existing clients and nearly doubled first-half pretax profits. We also hung on to eBay, Amazon.com, and e-jeweler Blue Nile when e-tailers took an earnings hit. They rewarded us with strong second quarters. Google rose 48%, too.

But the fun part of keeping the Web 20 is learning from mistakes. We dropped online broker Ameritrade because of low NASDAQ volume and DVD-by-mail provider Netflix because competition from Blockbuster's online service forced price cuts that sapped profits. Bummer. Netflix scored a fast turnaround as Blockbuster struggled, and Ameritrade got a takeover bid from rival E*Trade Financial, which it rejected. Netflix and Ameritrade both soared 80%. Meanwhile, newcomers InfoSpace, an online advertising play, InPhonic, whose Wirefly.com site lets consumers compare wireless phone plans, and realtor ZipRealty all tanked.

WELCOME BACK

IN OUR LATEST round of Web 20 adjustments, Infospace goes after two weak profit reports. We also cut Priceline.com, E*Trade, Chinese Web portal Sina, and Shopping.com, a price-comparison site being sold to eBay. We still like InPhonic and ZipRealty. InPhonic has had trouble digesting an acquisition, but CEO David Steinberg [illegible] closing duplicate facilities and ending unprofitable contracts. At 31 times 2006 [illegible] shares, with profits forecast to grow 30% a year, it's a bet that we'll let ride. ZipRealty, set to top $100 million in revenue and $10 million in pro forma profits this year, is on track.

Among our new picks we're welcoming back Netflix. It's pricey at 64 times this year's estimates, but it has room to cut marketing costs and raise prices as Blockbuster's threat recedes. We think Expedia, which IAC/InterActiveCorp. just spun off, is a better travel play than Priceline. Merrill Lynch says Expedia will generate 2005 cash flow of $740 million—putting its value around 10 times cash flow—despite problems at its Hotels.com unit.

IAC/InterActiveCorp owns everything from home shopping network HSN to Match.com. But watch two big growth sources: search engine Ask Jeeves and loan-referral service LendingTree. Jeeves will vie for $4 billion in advertising that consultants from the Kelsey Group in San Francisco say will move online by 2008 from print Yellow Pages. IAC's financial-services unit tripled first-half profits by boosting lending and real-estate referrals.

The New Web 20

- aQuantive
- Amazon.com
- Audible
- Blue Nile
- Ctrip
- CheckFree
- Digital River
- eBay
- Expedia
- Google
- IAC/InterActiveCo
- Infosys
- InPhonic
- Netflix
- Provide Commerc
- Quality Systems
- Shanda
- Websense
- Yahoo!
- ZipRealty

New members are listed in red

We think the next big Net wave is reengineering health care, so we like Quality Systems, which makes software for doctors' offices. Even after jumping to 65 a share from 25, QSI trades at a p-e of 40—not bad, considering expected 30%-a-year profit growth. Our last pick is Audible, a purveyor of downloadable spoken media such as audio books. Analysts think 2006 profits will rise sixfold, making Audible a reasonable speculation even at 31 times 2006 estimates.

If there's a lesson in the Web 20's performance, it's this: Stick to your guns. This time, we're even more prepared to ride out the rough patches with companies that are fundamentally sound. ■

BusinessWeek online To learn more about companies in the BW Web 20, visit businessweek.com/extras

Diving Into Watsu Massage

Underwater therapy is catching on at health resorts—but it's not for everyone. **BY LAUREN YOUNG**

AFTER A STRESSFUL six-hour flight to Tucson from New York with my husband and 3-month-old son in tow, I arrived at Canyon Ranch Health Resort a few months ago desperate for respite from weeks of sleep deprivation. The staff nurse I was assigned to took one look at the circles under my eyes and suggested that I try Watsu, an underwater massage.

I'd heard about Watsu—especially from the massage therapist I see at home—so I was curious to try it. Typically performed in a specially designed pool heated to body temperature, Watsu is a series of gentle movements and stretches intended to relax your body. It was invented in 1980 by Harold Dull, a Northern California massage therapist who offered the treatment in local hot springs. It incorporates techniques from zen shiatsu, an ancient Chinese pressure-point therapy believed to release blockages along the body's meridians where *chi*, or energy, flows.

The Watsu Institute, Dull's massage school in Middletown, Calif., has trained more than 5,000 practitioners. "Our goal is a world where everybody holds and floats each other in their arms," Dull says. That may take a while, but in the meantime, Watsu is popping up on more spa menus. In many cases, resorts are building dedicated Watsu pools.

Medical research shows that floating in warm water can be soothing, especially for acute and chronic pain. Warm water may have mental benefits, too. "Once you've been wrapped in water a bit, your mind starts to slow down," explains Keith McDaniel, a Watsu therapist at Canyon Ranch in Tucson. "You're between dreaming and being awake, and all of the little things go out the window." Even better for me, Watsu is supposed to relieve stress and help you sleep.

I arrived at my session wearing a bathing suit, which most practitioners prefer that you do. I hopped into a pool about 14 feet in diameter with water that was four feet deep and warm as a bath. Darcy Conner, the Watsu therapist, spent a few minutes talking to me about my new-mom lifestyle as well as my numerous ailments (pain in my lower back, neck, and knees, as well as insomnia).

Darcy cradled my body in her arms, holding my neck in her elbow and using her other hand to support my lower back. "Take a deep breath," she instructed. I kept my eyes closed during the next 50 minutes, as she pushed and pulled my body through the water, keeping my face above the surface. I felt as if I were dancing as my arms and legs flowed and waved in the water. Darcy gently massaged my entire body with a firm-but-soft touch, focusing on my back, neck, and shoulders. I emerged an hour later feeling mellow and dazed.

GO WITH THE FLOW A session at Canyon Ranch in Tucson

RAVE FROM MOM

I'D LIKE TO SAY I slept well after the treatment, but a baby is an obstacle. Rave reviews for Watsu, however, came from my mom, who was traveling with us. (It wouldn't be much of a vacation without a babysitter.) She was giddy after her session—"I've been reborn!"

Still, Watsu isn't recommended for people who are not used to being massaged. "It's a very specialized experience, one that requires a considerable amount of trust and maturity," says David Erlich, spa director at the Fairmont Sonoma Mission Inn & Spa in Sonoma, Calif. I didn't mind that a stranger was touching me, but having my ears move in and out of the water felt weird. I wish I had used the earplugs Darchy offered at the start of the session.

Most spas charge about $150 per hour for Watsu. To learn more about it, watch a 10-minute orientation video with Dull at waba.edu. The site also provides a list of more than 100 Watsu practitioners nationwide. Lucky for me, my massage therapist is studying at the Watsu Institute. I'm counting down the days until she returns to New York, and we can take the plunge together.

The Perfect Second Car?

Scooters are scoring because of their mileage and maneuverability. **BY ADAM ASTON AND ROB DOYLE**

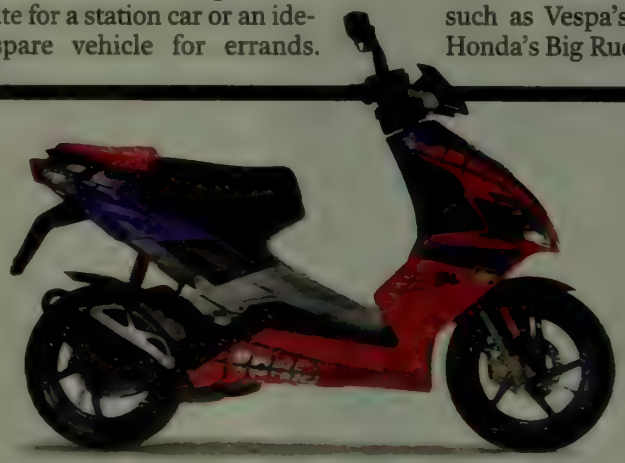
THE MAJESTY It can comfortably cruise on highways

HIGH GAS PRICES AND traffic: They're the banes of a driver's existence. With neither about to improve anytime soon, there may be a small solution to these big problems. Scooters are an increasingly popular way to zip to errands, make parking a snap, and cut down on fuel costs.

Smaller and easier to use than their motorcycle cousins, scooters have long been popular in cities in Europe, Asia, and Latin America. But lately, the economics of scootering has helped them gain fans here in the U.S. With a final bill that won't exceed most credit-card limits, a scooter makes a great substitute for a station car or an ideal spare vehicle for errands. That's why sales are soaring in urban hot spots such as Miami and New York as well as in the suburbs.

All scooters share a basic ease of operation that makes it easy even for non-motorcyclists to get on and go. Start with the motor, where automatic "twist-and-go" transmissions are the rule. With no clutch to fuss about, you simply twist the accelerator to take off. The brakes work just like a bicycle's, with a lever for each hand. Thanks to the positioning of the engine—directly in front of the rear wheel—scooters share a "step-through" design so you can sit upright, with your feet in front of you.

To get rolling, 50cc models such as Aprilia's spritely DiTech start at under $3,000. In the middle of the pack, models such as Vespa's classic Granturismo or Honda's Big Ruckus have enough oomph to take two passengers to highway speeds and sell for over $5,000. The most powerful class of touring-style rides—such as Yamaha's Majesty—comfortably cruise at highway passing speeds and can cost $6,000 and above. Also expect to ante up for insurance—around $400 per year for basic liability, fire, and theft—plus hel-



APRILIA SR50 DITECH
aprilia.com
PRICE: $2,999
ENGINE: 49CC
MILEAGE/RANGE: 120 MPG/252 MILES
With its Spiderman paint job, the 1[illegible]-lb. DiTech can make you feel like a superhero cutting through tight urban traffic. But with a relatively small 49cc power plant, its top speed is limited, making it ill-suited for highways.

HONDA BIG RUCKUS
powersports.honda.com
PRICE: $5,499
ENGINE: 249CC
MILEAGE/RANGE: 60 MPG/192 MILES*
Its rugged design makes the Big Ruckus at home in the city and in the country, and the exposed frame offers a handy way to chain it up. Wherever you go, the edgy styling elicits lots of questions and stares.

Scooters are easy to operate, even for novice riders

nets, and the cost of a motorcycle licensing course, if necessary.

Running costs are even more appealing. Larger scooters get up to 60 miles per gallon; some, such as Aprilia's DiTech, can go twice as far on a gallon of gas. The DiTech's spartan efficiency comes from its high-revving, clean-running two-stroke 49cc power plant. A plus for this small engine is that in many states no special license is required on vehicles with engines under 50cc. The trade-off is a top speed south of 50 mph, so it's not the right choice for the highway. Rather the DiTech's sub-200-lb. weight and agile, short wheelbase make it a perfect runabout, easy to stash in small parking nooks at the deli or train station.

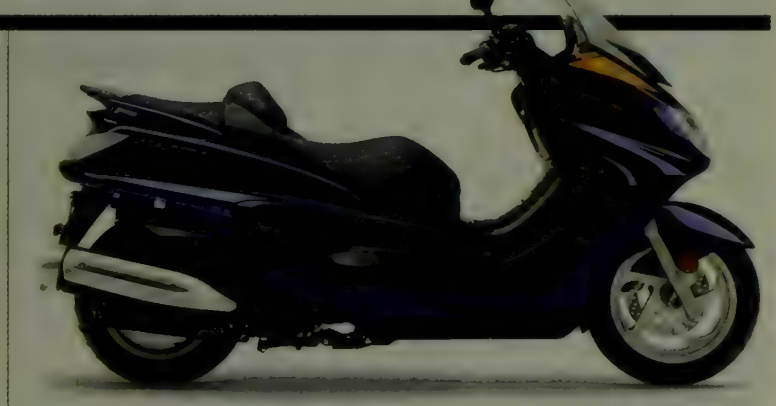
For longer journeys and more rugged urban byways, it's nice to have a little more power on tap. All the better if it's wrapped in a Vespa's timeless, forward leaning curves. Under the sculpted steel skin of the Granturismo, maker Piaggio has crammed a modern 198cc deep-purring, four-stroke single-cylinder engine that can comfortably—and stylishly—carry two adults, along with a few bags of groceries hung off the handy hook just below the handlebars.

If the Vespa is almost too pretty to risk the inevitable dings and dents of urban riding, the perfect substitute is Honda's Big Ruckus. With no metal or plastic panels to mar, this stripped-down ruffian barely notices the occasional sidewalk scrape. Its exposed frame not only looks tough but offers a great way to lock the bike up. Even bouncing over potholed Manhattan cross streets, the Big Ruckus feels more stable at higher speeds, thanks to a 249cc engine and a longer-wheel base.

For trips beyond city limits, a new class of supersized scooters offers the feel of a motorcycle but with less hassle. With its 400cc engine and tall windshield, Yamaha's Majesty is a great choice if you prefer to skip the train station and cruise directly to work at 65 mph on the highway. Once in the city, at 436 lb., Majesty is less agile than, say, the nimble DiTech in gridlocked traffic. But the Majesty offers features the DiTech can't touch, such as an underseat trunk big enough to hold two helmets—or Chinese food for four. Next time you need to pick up a takeout order, why drive when you can scoot? ■

BusinessWeek online For more on the scooters below and suggestions for others in each category, go to businessweek.com/extras

SPA GRANTURISMO
ba.com
CE: $5,499
GINE: 198CC
EAGE/RANGE: 60 MPG/156 MILES*
ix of 1950s looks and 21st century components, the Granturismo rs *Roman Holiday* romance without all the black oily smoke. The ated classic relies on a quiet four-stroke 198cc engine that can fortably hit highway speeds.



YAMAHA MAJESTY
yamaha-motor.com
PRICE: $5,799
ENGINE: 400CC
MILEAGE/RANGE: 60 MPG/222 MILES*
It's not as nimble as the smaller scooters, but it's more stable and comfortable on long rides, even for two riders. Because of its size, the Majesty has ample underseat storage space—enough for two helmets.

*BW Estimates

EDITED BY TODDI GUTNER

HEALTH CARE

MAKING IT EASY TO SIZE UP A HOSPITAL

FEW DECISIONS ARE more important than what hospital you should choose to treat a serious illness. But most Web resources that rate the quality of care at hospitals dole out data through the sites of health plans or big employers.

That will change on Sept. 1, when Chicago-based Subimo opens **MyHealthcareAdvisor.com** to the public at $12 for a six-month subscription. The company says the launch is a reaction to a good review *BusinessWeek* gave Subimo's employer-distributed ratings in June, which produced thousands of requests for a public site. Subimo ranks hospitals from 1 to 100 on factors such as complication rates, cost, and use of technology. For many diseases, it also summarizes research so patients can explore new treatments. "As people pay more of their health-care costs, there's a place for tools that will help them manage their own care," says Subimo Vice-President Joe Donlan. *–Timothy J. Mullaney*

WINE

Château Main St.

A VISIT TO THE CALIFORNIA, Oregon, or Washington wine country used to require a trip out of town. No longer. A growing number of West Coast vintners are working in garages, warehouses, and houses in cities—either as a sideline to other jobs or because they prefer urban living. They purchase their grapes from growers and truck them in—and some are producing award-winning wines. "We choose to live where our market is," says Ben Smith, co-owner of Seattle's **Cadence Winery.**

A rising star in Washington winemaking, Cadence has won acclaim for its merlot and cabernet sauvignon blends (cadencewinery.com, 206 381-9507). **Jaffurs Wine Cellars** has a Santa Barbara (Calif.) facility that uses grapes from nearby vineyards to produce Rhône varietals like syrah and grenache (jaffurswine.com, 805 962-7003).

The wineries usually require appointments for tours or tastings, but you can drop by Jaffurs; **Rosenblum Cellars** in Alameda, Calif. (rosenblumcellars.com, 510 865-7007), and **Urban Wineworks** in Portland, Ore. (urbanwineworks.com, 503 226-9797). Traveling to these wineries may not be scenic, but the ride is shorter. *–Kristina Shevory*

TIME OFF

ANSEL ADAMS'S iconic black-and-white photographs of Yosemite National Park have graced millions of wall calendars. But the San Francisco photographer had many other subjects. Drawing on the largest private collection of Adams's work, the Museum of Fine Arts in Boston (mfa.org) will showcase rarely seen shots of the artist's friends, New Mexican pueblos, and urban scenes in an exhibit through Dec. 31 of 180 photographs. *–Aaron Pressman*

CAMERAS

A VIDEO CAM YOU CAN TOSS

PICTURE QUALITY is so-so, and it's a lot of cash for 20 minutes of video. But if you're caught without your camcorder or just don't want to haul it around, here's a passable option. Drugstore chain CVS sells a **recyclable, single-use digital one for $30,** plus $13 for transferring the video clips to a DVD. It's not good indoors. But it fits into a shirt pocket, it's simple to use, and its 20-minute limit is plenty for most home movies. *–Larry Armstrong*

(TOP) ROBERT NEUBECKER; (LEFT) TIM GRAJEK; (BOTTOM) PHOTOGRAPH BY ANSEL ADAMS. USED WITH PERMISSION OF THE TRUSTEES OF THE ANSEL ADAMS PUBLISHING RIGHTS TRUST. ALL RIGHTS RESERVED

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BY GENE G. MARCIAL

ALASKA AND AMERICAN ARE FLYING ABOVE THE AIRLINE STORMS.

ONE U.S. HOMEBUILDER ON A SOLID FOUNDATION IS TARRAGON.

ATHEROGENICS' NEW ARTERY DRUG COULD CATCH MERCK'S EYE.

Climbing: Alaska and AMR

REELING FROM MOUNTING FUEL COSTS, airline stocks are getting pummeled. The Street continues to see them as outcasts and heavily laden with risks. But David Strine of Bear Stearns, who is generally down on airlines, sees two exceptions to his dark view: He is upbeat about Alaska Air Group (ALK) and AMR (AMR), parent of American Airlines, and rates them "outperform." While other airlines have dived, both Alaska and AMR have risen: Alaska winged up from 26 in April to 33.61 on Aug. 24 and AMR from 10 to 13.55. (AMR was discussed in this column on Mar. 28 when it was at 8.) Strine says Alaska is trading at a discount to its peers and to its own historic multiples. Strine figures the stock will hit 40 by yearend. The airline posted second-quarter profits of 74¢ a share—higher than Strine's forecast of 65¢. Because of an improving revenue outlook, he has raised his earnings forecast for 2005 from $1.61 a share to $1.90, and for 2006 from $3.30 to $3.50. He notes Alaska is well fixed for fuel, with 50% of its needs hedged for the rest of 2005 at $30 a barrel, 41% in 2006 at $40, and 20% in 2007 at $45. Alaska serves more than 80 U.S. cities, plus Canada and Mexico. Ray Neidl of Calyon Securities rates Alaska "add," with a price target of 38. On AMR, Strine says it has a "substantially lower liquidity risk profile than its peers," given its $3.9 billion cash stash and its "more moderate cash burn." AMR is expected to post a loss this year—but much less than 2004's loss of $5.57 a share. Strine sees AMR earning 40¢ a share in 2006, up from his earlier estimate of 30¢. Recent fare hikes, increased bookings, and declining competition in some markets helped, he says. Goldman Sachs also rates AMR "outperform."

BEAR STEARNS'S AIRLINE BETS

STOCK	AUG. 24 PRICE	52-WEEK HIGH-LOW	YEAREND TARGET
ALASKA AIR (ALK)	33.61	35.72-19.72	40
AMERICAN (AMR)	13.55	14.95-10.34	17

Data: Bloomberg Financial Markets, Bear Stearns & Co.

Discover the e

This itsy bitsy Spider (SPY) goes a long way. In fact
Spiders are an exchange traded fund (ETF), so they
risks. Ask your advisor for details. Because the

STATE STREET GLOBAL ADVISORS | SSgA.

An investor should consider investment objectives, risks, charges and expenses of the investment company carefully b
Please read the prospectus carefully before investing. *Usual brokerage commission applies. Since inception in 1993, the SPD
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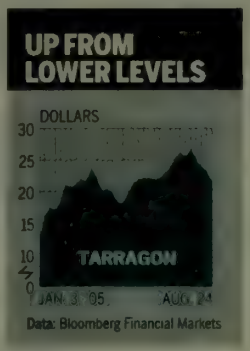
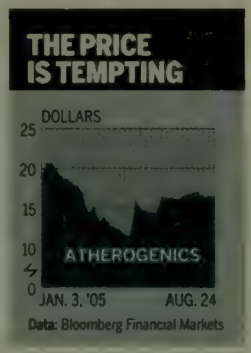
Tarragon Is Raising the Roof

WHETHER OR NOT HOUSING SLOWS, Lee Schultheis is betting on a homebuilder, Tarragon (TARR), whose stock is up from 12 on Jan. 3 to 21. At 5.25 times his 2006 profit forecast of $4 a share, this little-known stock is cheap, says Schultheis, chief strategist at Alternative Investment Partners, which owns shares. This builder of condominiums and town houses in high-density cities—mainly in Florida, Tennessee, Texas, and the Northeast—wouldn't be much affected if housing demand fell: Dwellings are scarce in these places, Schultheis says. In the second quarter, backlog sales (houses sold but not yet delivered) were up 76% from a year ago, to $557 million, notes Schultheis. Tarragon, he says, is a "huge earnings-growth play in housing." His 2005 earnings estimate is $2.65 a share, up from 2004's $1.29. Barclays Bank owns nearly 2% of the stock.



AtheroGenics May Be a Buyout

AS BIG PHARMA CONTINUES to scout for biotechs developing major new drugs, John McCamant, editor of the *Medical Technology Stock Letter*, thinks AtheroGenics (AGIX) is "one of the more attractive acquisition candidates." Its lead product, AGI-1067, is an oral anti-inflammatory agent that has shown, in Phase 2 clinical trials, that it not only slows atherosclerosis—a leading cause of coronary artery disease—but actually reverses it. A few years ago, Merck was close to buying Esperion Therapeutics for its intravenously applied cardiovascular drug—until Pfizer made a higher bid. Now, Merck may go after AtheroGenics, whose product is superior to Esperion's, says McCamant. Despite its current woes, he expects Merck will continue to pursue its goals in the billion-dollar anti-inflammation market. AtheroGenics will soon hold Phase 3 trials for AGI-1067. "Given the favorable data in earlier trials, we doubt potential suitors will wait for the next trial before making their move," he says. Pfizer certainly did not wait for Esperion's data, adds McCamant. "We know there is a lot of interest in AGI-1067." AtheroGenics is in serious talks with big drugmakers for a marketing pact for AGI-1067, he says, "but if the right suitor comes along, it may just sell the whole company." McCamant says AtheroGenics is worth 40. The stock hit 38 last September on excitement over its new drug but fizzled when Pfizer bought Esperion. It's now at 16. Joel Sendek of Lazard rates it a strong buy. Thomson First Call's consensus estimates a loss of $2.23 a share in 2005 and a loss of $1.51 in 2006. Merck and AtheroGenics declined comment.



BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

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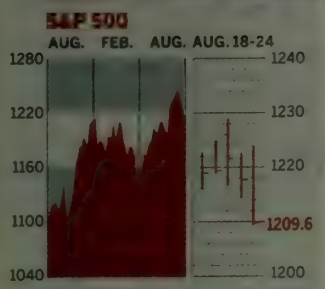
Personal Business Figures of the Week

STOCKS



COMMENTARY

Oil prices soared to a new high of $67 a barrel on Aug. 24, rocking the markets and prolonging a week-long slide. The Dow and the S&P 500 were down about 1% for the week. The Commerce Dept.'s report that orders for durable goods were lower than expected in July didn't help. At least the housing market was still robust, with July new-home sales hitting a new record.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	AUG. 24	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1209.6	-0.9	-0.2	10.3
Dow Jones Industrials	10,434.9	-1.1	-3.2	3.3
NASDAQ Composite	2128.9	-0.8	-2.1	15.9
S&P MidCap 400	702.4	-0.1	5.9	23.1
S&P SmallCap 600	341.1	-0.3	3.7	23.2
DJ Wilshire 5000	12,074.3	-0.7	1.0	13.4
SECTORS				
BusinessWeek 50*	720.1	-0.6	2.2	15.1
BW Info Tech 100**	361.4	-1.5	-3.2	12.8
S&P/BARRA Growth	573.2	-0.9	-0.5	8.1
S&P/BARRA Value	626.2	-0.9	0.1	12.5
S&P Energy	368.0	2.0	27.5	48.6
S&P Financials	393.6	-1.1	-4.2	2.8
S&P REIT	150.9	0.0	4.5	19.0
S&P Transportation	217.3	-1.0	-10.0	8.6
S&P Utilities	161.2	1.9	13.8	29.4
GSTI Internet	170.9	-2.5	-4.2	24.5
PSE Technology	794.7	-0.6	2.0	21.6

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	AUG. 24	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST MONTH
S&P Euro Plus (U.S. Dollar)	1417.6	-0.7	1.5	2.[illegible]
London (FT-SE 100)	5275.2	-0.3	9.6	1.[illegible]
Paris (CAC 40)	4424.4	-0.3	15.4	2.[illegible]
Frankfurt (DAX)	4916.0	0.9	15.5	[illegible]
Tokyo (NIKKEI 225)	12,502.3	1.9	8.8	1.[illegible]
Hong Kong (Hang Seng)	14,873.9	-3.7	4.5	1.[illegible]
Toronto (S&P/TSX Composite)	10,509.7	0.1	13.7	2.[illegible]
Mexico City (IPC)	14,603.0	0.3	11.0	4.[illegible]

FUNDAMENTALS	AUG. 23	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	2.05%	2.04%	1.7[illegible]
S&P 500 P/E Ratio (Trailing 12 mos.)	19.0	19.2	19.5
S&P 500 P/E Ratio (Next 12 mos.)*	15.2	15.3	16.0
First Call Earnings Revision*	0.50%	-0.10%	0.06

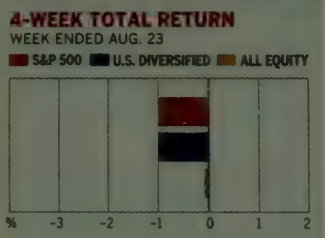
*First Call C[illegible]

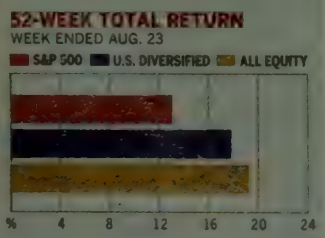
TECHNICAL INDICATORS	AUG. 23	WEEK AGO	READ[illegible]
S&P 500 200-day average	1194.4	1192.6	Positi[illegible]
Stocks above 200-day average	62.0%	64.0%	Neutr[illegible]
Options: Put/call ratio	0.83	0.79	Positi[illegible]
Insiders: Vickers NYSE Sell/buy ratio	5.35	5.56	Negati[illegible]

BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Instrumentation	7.8	Oil & Gas Refining	102.0
Oil & Gas Refining	7.1	Oil & Gas Drilling	78.8
Educational Services	6.8	Oil & Gas Exploration	76.0
Oil & Gas Equipment	4.5	Fertilizers & Ag. Chems.	71.0
IT Consulting	4.5	Managed Health Care	62.9

WORST-PERFORMING GROUPS	LAST MONTH %		LAST MONTH
Homebuilding	-13.4	IT Consulting	-34.[illegible]
Specialty Appar. Retailers	-10.8	Insurance Brokers	-23.[illegible]
Comptr. Stge. & Perphs.	-9.8	Automobiles	-23.[illegible]
Airlines	-8.8	Paper Products	-19.[illegible]
Food Wholesalers	-8.6	Motorcycles	-17.[illegible]

MUTUAL FUNDS





Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Japan	9.2	Latin America	62.1
Latin America	7.3	Natural Resources	53.4
Precious Metals	5.0	Diversified Emerg. Mkts.	43.3
Diversified Pacific/Asia	4.9	Europe	33.1
LAGGARDS		**LAGGARDS**	
Real Estate	-3.3	Domestic Hybrid	10.7
Small-cap Value	-1.7	Financial	11.5
Small-cap Blend	-1.6	Precious Metals	12.9
Small-cap Growth	-1.6	Large-cap Blend	13.2

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Fidelity Japan	12.2	Guinness Atkn. Gl. Energy	84.8
Scudder Japanese Equity S	12.1	ProFunds Oil & Gas Inv.	78.9
ProFunds Ultra Japan Inv.	12.0	U.S. Glbl. Invs. Gl. Rscs.	75.9
Rydex Large Cap Japan	11.8	BlackRock Gl. Res. Inv. A	74.4
LAGGARDS		**LAGGARDS**	
Frontier MicroCap	-8.7	Ameritor Investment	-56.0
Alpine U.S. Rl. Est. Eq. Y	-7.8	ProFds. USh. Mid Cap Inv.	-35.3
Grand Prix Super Core A	-7.8	ProFds. USh. Sm. Cap Inv.	-34.0
ProFunds. Real Est. Inv.	-7.4	Rydex Dyn. Vent. 100 H	-25.4

INTEREST RATES

KEY RATES	AUG. 24	WEEK AGO	YEAR AGO
Money Market Funds	3.0[illegible]%	2.97%	0.99[illegible]
90-Day Treasury Bills	3.49	3.51	1.53
2-Year Treasury Notes	3.9[illegible]	4.05	2.45
10-Year Treasury Notes	4.17	4.27	4.27
30-Year Treasury Bonds	4.3[illegible]	4.48	5.06
30-Year Fixed Mortgage †	5.71	5.79	5.76

†BanxQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.68%	4.33%
Taxable Equivalent	5.26	6.19
Insured Revenue Bonds	3.84	4.50
Taxable Equivalent	5.49	6.43

THE WEEK AHEAD

FACTORY INVENTORIES *Tuesday, Aug. 30, 10 a.m. EDT* » Manufacturing inventories most likely rose slightly in July, after June inventories dipped 0.1%.

GROSS DOMESTIC PRODUCT (REVISED) *Wednesday, Aug. 31, 8:30 a.m., EDT* » Even with revisions, growth in real gross domestic product is forecast to have held at the initially reported annual rate of 3.4% for the second quarter. That's the median forecast of economists surveyed by Action Economics.

PERSONAL INCOME *Thursday, Sept. 1, 8:30 a.m. EDT* » In July, personal income probably posted a second straight monthly gain of 0.5%. At the same time, consumer expenditures most likely grew 0.9%, after a 0.8% jump in June.

PURCHASING MANAGERS' INDEX *Thursday, Sept. 1, 10 a.m. EDT* » The Institute for Supply Management's factory activity index is expected to have edged up to 56.9% for August. For July, the index jumped up to 56.6%.

EMPLOYMENT *Friday, Sept. 2, 8:30 a.m. EDT* » August nonfarm payrolls most likely increased by 188,000, after a better-than-expected gain of 207,000 in July. Factories probably cut 4,[illegible]00 jobs for a second straight month. The jobless rate very likely held at 5.0%.

The *BusinessWeek* production index edged down to 250.9 for the week ended Aug. 13, but stood 11.8% above the previous-year level. Before calculation of the four-week moving average, the index rose to 252.7

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/extra.htm

The Companies

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

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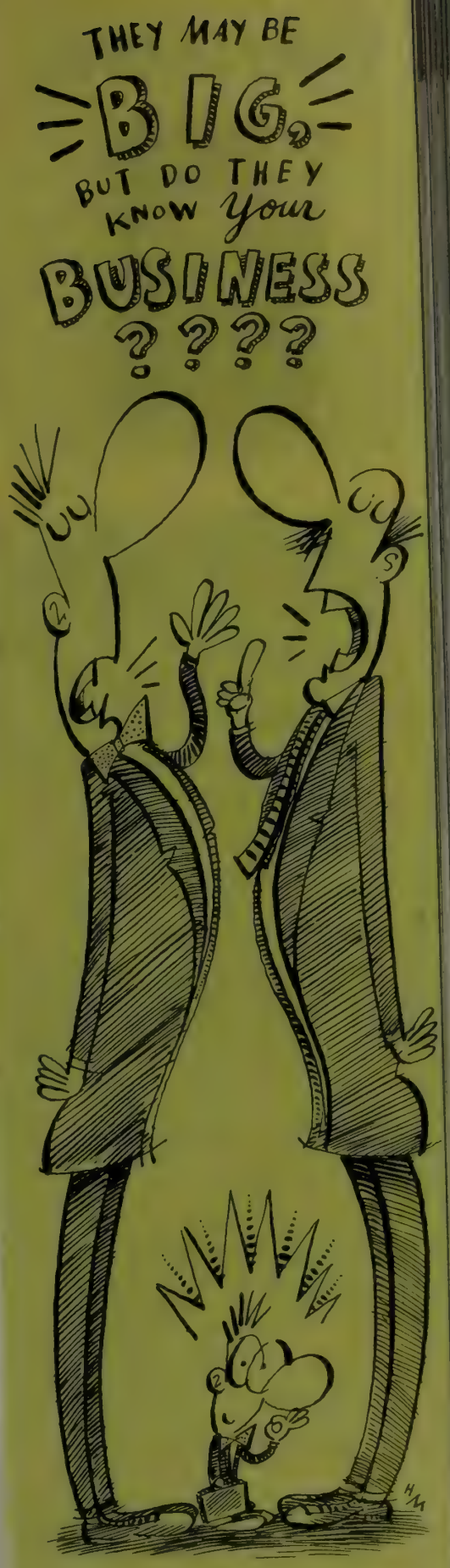

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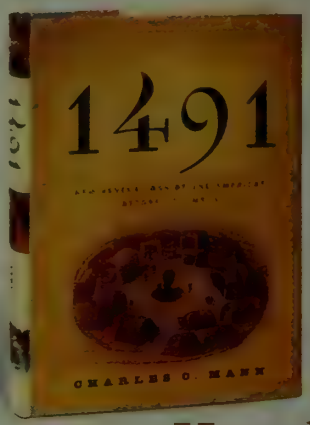
IdeasBooks

Cradle of Civilization

1491 New Revelations of the Americas Before Columbus
By Charles C. Mann; Knopf; 465pp; $30

Ah, the Amazon. The legendary rain forest spreads across much of South America and is home to about a third of the world's animal and plant species—and very few humans. Among the latter is the much studied Yanomamo tribe of central Brazil. These indigenous people employ the age-old technique of slash-and-burn, using machetes and fire to clear jungle and expose a patch of land for farming. Then, as the fast-growing wilderness returns to claim the area, the Indians move away, following a rhythm developed over millennia. It's one of the few approaches that works, since the Amazon is so inhospitable to modern agriculture. Today, environmentalists are fighting not only to defend the rain forest against loggers, miners, and developers but also to safeguard this Indian way of life that's in harmony with nature.



We're all familiar with some version of this story. Problem is, it's almost entirely untrue, argues Charles C. Mann in his fascinating *1491: New Revelations of the Americas Before Columbus.* As Mann tells us, some anthropologists and archaeologists are convinced that the Yanomamo are relative newcomers to the region, refugees from more sophisticated societies farther south who sought safety in the rain forest from 17th-century European invaders and their diseases. Slash-and-burn, these scholars now say, is a relatively new invention, made possible only by the importation of steel blades from Europe. Even more astonishing, says Mann, a growing body of scholarly work suggests that much of the Amazon's diverse tree population is cultivated. With the jungle impenetrable, Indians devised an ingenious farming solution—planting trees right in the forest that would produce a cornucopia of fruits, nuts, and other edibles. Writes Mann: "They were in the midst of terra-forming the Amazon when Columbus showed up and ruined everything."

Surprising, intriguing stories like this fill the pages of *1491.* A correspondent for *Science* and *The Atlantic Monthly,* Mann taps into recent scholarship that challenges the conventional wisdom about Indian culture, society, and politics. The revisionists argue that the America Columbus encountered did not consist of a pristine landscape home to a relatively small number of illiterate and innumerate Indians living close to the land. Instead, vast civilizations had long flourished throughout the Americas, especially below the Rio Grande. The legendary Maya and Aztec civilizations, as well as the lesser-known Tiwanaku and Wari among others, built giant cities with magnificent public architecture and lively intellectual life.

How the Americas flourished before the Spanish conquest

For instance, in 1000 A.D., the city of Tiwanaku (now in Peru) may have had a population of 115,000, with a further 250,000 in the countryside. Paris wouldn't reach that scale for another five centuries. Trade flourished across North America. "It was, in the current view, a thriving, stunningly diverse place, a tumult of languages, trade, and culture, a region where tens of millions of people

oved and hated and worshiped as people do everywhere."

Why has this history been hidden for so long? Blame diseases brought by Europeans, especially smallpox. Much of what explorers described as uninhabited had really been depopulated by disease.

Take the Inka. Francisco Pizarro and his 168 men and 62 horses came upon these people in the early 16th century. The Inka had constructed the largest empire in the world, bigger even than that of the Ming dynasty or the Ottomans. Yet as every school child knows, Pizarro's small force defeated them. He did this partly by exploiting factional rivalries among the Inka elite. Moreover, far less appreciated until recently, in five waves between 1524 and 1565, smallpox epidemics wiped out millions of Inka. Disease and subjugation masked these vibrant Indian civilizations from future generations. That is, until now.

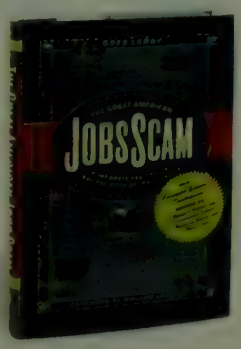
Many of these ideas are controversial. The scholars delving into Indian history are portrayed by Mann as a contentious, jealous bunch. And the author is hardly neutral: In each controversy he describes, Mann leans toward the side that makes Indian culture seem the most advanced. Moreover, parts of *1491* get bogged down in scientific descriptions and academic debates, and at times the story gets so dense it's hard to follow. But those are minor irritants. The real triumph of *1491* is to make a compelling case that Mesoamerica, much like the Fertile Crescent of the Middle East, was a cradle of civilization. Would-be textbook writers, take note. ■

–By Christopher Farrell

In Brief

The Big Giveaway

THE GREAT AMERICAN JOBS SCAM
Corporate Tax Dodging and the Myth of Job Creation
By Greg LeRoy; Berrett-Koehler; 290pp; $24.95



For years, economists have pointed out how unproductive it is for states and localities to dole out tax breaks in order to influence the location of new plants or offices. It turns out that the practice is even more widespread—and damaging—than many critics have thought, according to *The Great American Jobs Scam: Corporate Tax Dodging and the Myth of Job Creation*. As is clear from the title, author Greg LeRoy is no impartial observer. He came to the subject after years of helping labor unions battle plant closings in the Midwest. Still, he has compiled a powerful compendium on a practice that has become standard operating procedure in recent decades.

Overall, states and cities today surrender some $50 billion a year through a bewildering variety of corporate tax breaks that are at least nominally intended to lure development, according to several studies the book cites. The fiscal impact has hit nearly every state, each of which now has an average of 30 different corporate-subsidy programs. Since 1980, this proliferation has helped to halve the share of state-tax revenues contributed by corporations—to just 5% today.

Most disturbing is evidence that states and cities are usually paying companies to do what they would have done anyway. Using both specific examples as well as broader studies, LeRoy shows how companies pit prospective sites against one another to get the best tax deal—then usually locate the new facilities in the region they had chosen in the first place. In fact, an estimated 96% of company tax breaks are such windfalls, according to work LeRoy cites by University of Iowa professor Peter Fisher. To put it another way, officials are handing out millions to influence a minute number of job shifts. "I think of it like using dynamite to catch fish," writes LeRoy.

In the end, even the corporate beneficiaries take a hit. By undercutting the local infrastructure and skill base, they worsen the business climate of their new home, raising the cost of operating there. Of course, most companies have an out if subsequent tax dodgers run the place too far into the ground: They can always pull up stakes and seek greener pastures—and fresh tax breaks. ■

–By Aaron Bernstein

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IdeasViewpoint

BY JEFFREY E. GARTEN

B-Schools: Only a C+ in Ethics

Before I stepped down as dean of the Yale School of Management on June 30, the question I was most frequently asked by people outside the university was whether business schools were doing enough to instill the right values in their students. My answer: MBA programs have come a long way—but not nearly far enough. ¶ To be sure, I don't believe B-schools can turn someone who is dishonest into a virtuous person. Enron's former chief financial officer, Andrew Fastow, would likely have turned out to be a bad apple no matter what he was taught in graduate school. Nor can an MBA program give someone the backbone to make a moral decision that risks the loss of a company's market value, as happened at Johnson & Johnson in the 1980s when Chief Executive James Burke courageously took Tylenol off the shelves because of safety scares. That kind of character must be developed much earlier than the typical age of a B-school student, about 27.

What business schools can do, however, is teach students how to apply value judgments when issues are not black and white. An obvious place to start: the admissions process. In evaluating applications, business schools should ask prospective students pointed questions in their essays and interviews about ethical turning points in their lives. Admissions officials should also plumb views about current moral controversies in the business world. When soliciting references, business schools should specifically request input on a candidate's character. The answers to all these questions should be evaluated with the same seriousness as grades and test scores.

Schools need to do much more to help students make moral choices

BY THE TIME THEY GRADUATE, MBA students should be able to assess issues such as whether Hewlett-Packard Co.'s decision last month to make large-scale layoffs and sever pension programs fairly balanced the pressures for financial performance against obligations to loyal employees. They should have a view on whether Goldman, Sachs & Co.'s recent representation of both the New York Stock Exchange and Archipelago Holdings in a merger of the two, while holding financial stakes in both, constituted a conflict of interest or just an efficient consensual transaction. And these would-be leaders should be able to reason whether Microsoft Corp.—in its effort both to expand in China and also uphold Chinese law—is doing the right thing by helping Beijing prevent its citizens from researching concepts like democracy and human rights on the Internet. The idea is not for B-schools to provide simple right or wrong answers, but to prepare these future executives to better assess the morally complex choices they will face during their careers.

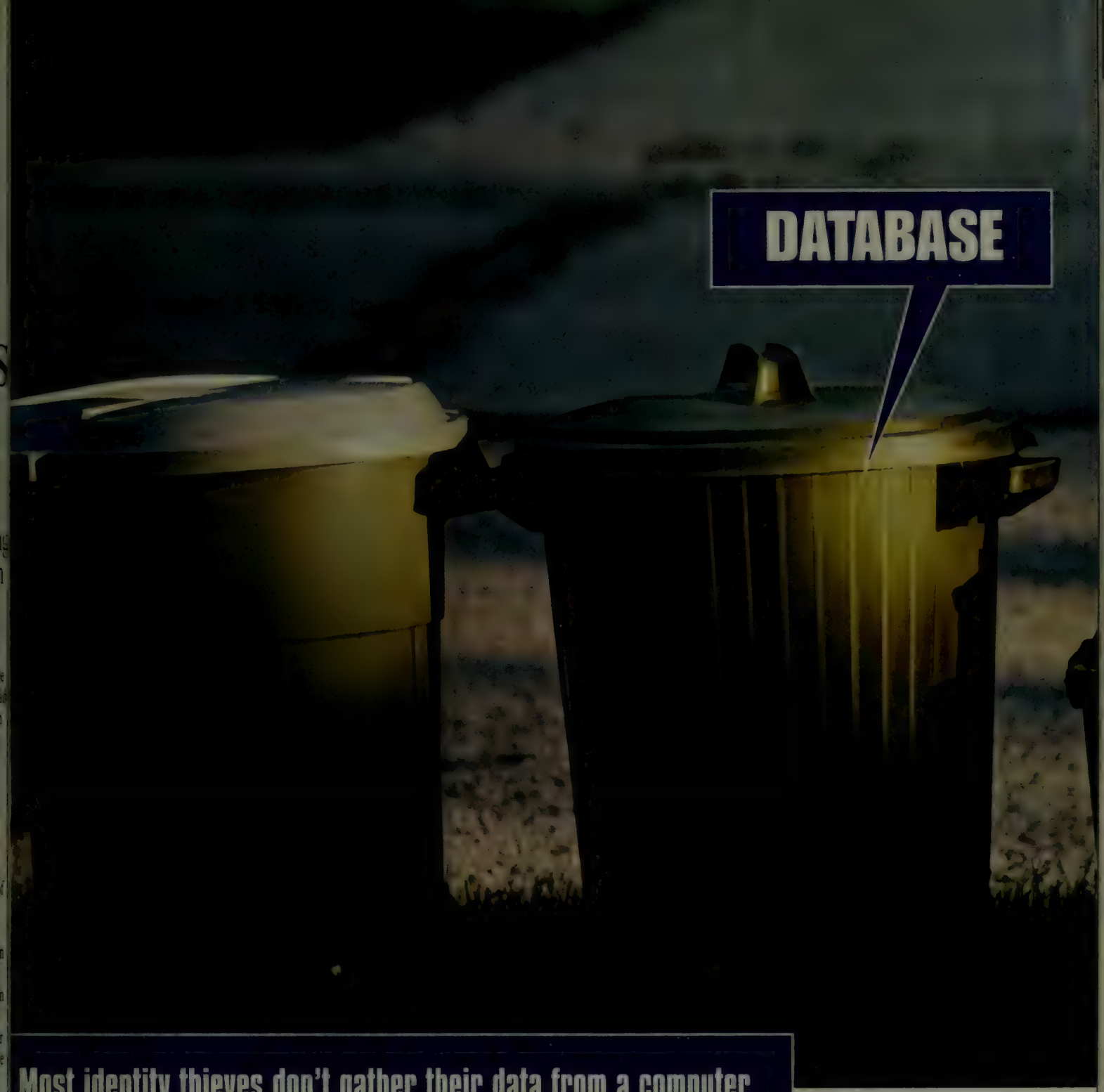
Top business schools are wrestling with such issues in different ways. Harvard requires all students to take a course on leadership and ethics. Dartmouth concentrates on a broad agenda of extracurricular consciousness-raising activities in which issues such as Merck & Co.'s handling of Vioxx are debated by students, professors, and people who have been directly involved. Columbia has established a research institute devoted to ethical leadership. And the new dean at Yale, Joel M. Podolny, is revamping the curriculum with a series of seminars on business ethics at its center.

But if such institutions were to really get serious about ethics, each should undertake a combination of all these programs. In addition, new courses should be added beyond what is normally required. All students, for example, should gain a fundamental understanding of business law. They should study relevant fiction, such as Tom Wolfe's *The Bonfire of the Vanities*, which explores character better than case studies ever could. And, to acquire context, they should take courses in business history, dissecting such books as Ron Chernow's *The House of Morgan*.

The most prestigious faculty should lead the way in promoting ethics, or students will quickly infer the subject is not critical. But most professors specialize in disciplines like finance or operations, and have little training in teaching values. As a condition for tenure, therefore, the next generation of lifetime faculty should be required to pass a rigorous exam on such matters, graded by experts inside and outside the academy.

The decisions made by business leaders have a tremendous impact on shareholders, employees, customers, suppliers, communities, and the broader economy. So enhancing their ethical education at a formative stage is arguably the highest priority that business schools should have. Although many are working at it, none has yet fully risen to that challenge. ■

Jeffrey E. Garten *is the Juan Trippe professor at The Yale School of Management (jeffrey.garten@yale.edu)*



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IdeasEditorials

Stop Playing Hide-and-Seek

MUTUAL FUND MANAGERS paying for spots on a brokerage's "preferred" list of funds. Investors buying recommended investments while disclosure of potential conflicts of interest involving their brokerage and mutual fund marketers is buried. A major brokerage house that sells virtually only those mutual fund families that pay it annual fees. If this all seems like déja vu, you're right. These practices are called revenue-sharing arrangements, but it might be more apt to call them "pay-to-play lite" (page 96).

Make no mistake: It's perfectly legal for fund companies and broker/dealers to pen such deals, just as food companies pay for shelf space for their products at local supermarkets. But investors need to know when the financial interests of their brokerage firms diverge from their own—especially since the estimated $2 billion a year spent on such revenue-sharing deals certainly raises the possibility that the balance could shift away from investors. Existing disclosure requirements are meager at best.

The investment industry for the most part complies with those requirements by making bare-bones information available—if investors are willing to hunt for it deep within rarely read prospectuses or obscure addenda. Rather than the uniform tables of sales charges and management fees now required of fund companies, much of the revenue-sharing disclosure data is provided in language that is often vague o so dense that many fund buyers never digest it.

All this must change. A good place to start would be the mutual fund sales disclosure rules being considered by the Securities & Exchange Commission. These regulations, proposed by former SEC Chairman William H. Donaldso before his departure earlier this year and still pending at the agency, deserve to move forward They would require that before a client buys a fund, a brokerage must disclose how much it expects to collect in revenue sharing on that sale.

Brokers and funds still cut deals, they just bury them in the fine print

That would be an improvemen over today's hide-and-seek disclosure. But even more information needs to be made available. An excellent model is the data that Smith Barney provides customers on a voluntary basis. The firm not only discloses the maximum revenue-sharing fee it charges fund families, but also details the hefty percentage of its fund sale that went to 37 favored fund families in 2004 that paid it (94%) and ranks those fund families in order from those tha paid the most to the least. That kind of data gives investors a clearer picture of the incentives Smith Barney has to pitch them particular funds and should be required of all broker/dealers.

To be sure, in the four years since the Wall Street scandals Washington has made huge strides in requiring disclosures for investors about fees, sales practices, and conflicts of interest. But when it comes to mutual fund revenue sharing, the SEC still needs to let a little more sunshine in.

High Birthrates: A Mixed Blessing

ANYONE NOT YET convinced that the world is changing fast has only to look at the estimates recently released by the Population Reference Bureau (PRB). The relatively good news for the U.S. is that its population is projected to grow 42% to about 420 million people by 2050. That compares with a forecast population drop of 10% in Europe and a hefty 21% plunge in Japan over that period.

Much of the credit for America's vibrantly growing population goes to immigration, currently adding about 1.2 million to the populace annually. Moreover, many of these immigrants tend to be of child-bearing age, and most have higher birthrates than native-born Americans. That's a positive for the economy because a larger populace, if sufficiently trained, creates a larger local market and more workers to produce more goods and services. Countries with stagnating population growth have to depend more heavily on productivity growth—a much chancier path to prosperity for mature economies. That's why Japan, an immigration-averse nation that just announced that its population would likely fall this year for the first time in history, is likely to have a hard time maintaining its economic stature as its population quickly ages.

Unfortunately, there's also a grim message from the PRB study: Much of today's population growth is occurring in parts of the world that can ill afford the increase. Africa will account for fully one-quarter of the earth's population rise this year. And if current trends continue, three African nation (the Democratic Republic of the Congo, Ethiopia, and Nigeria) will be among the world's 10 most populous by 2050—each bigger than Russia, Japan, or any European country. That's why bringing such poor countries into the world's economic mainstream is so essential. As China and India have shown, for even populous countries that embrace tough market reforms, no destiny need be preordained.

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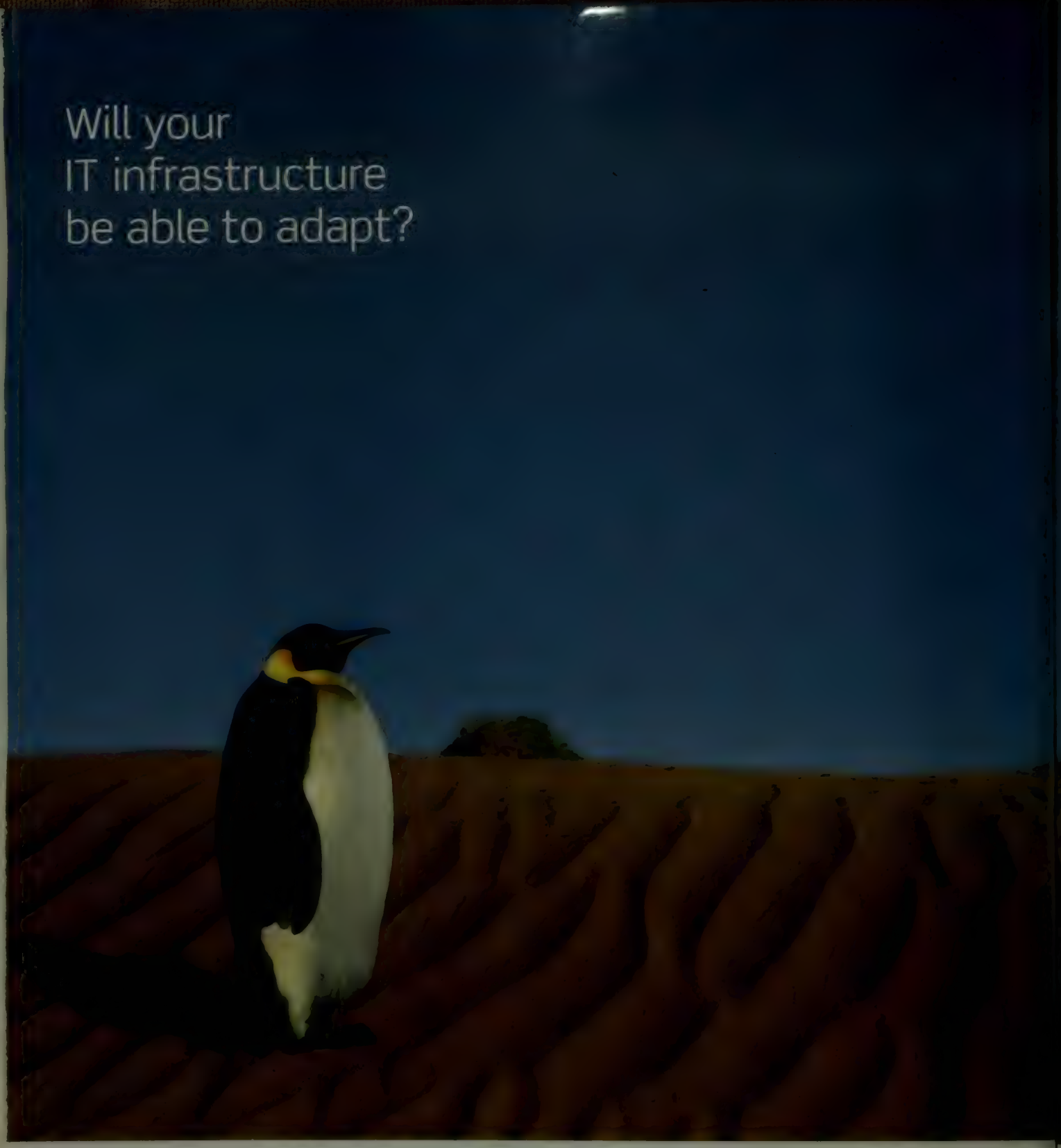

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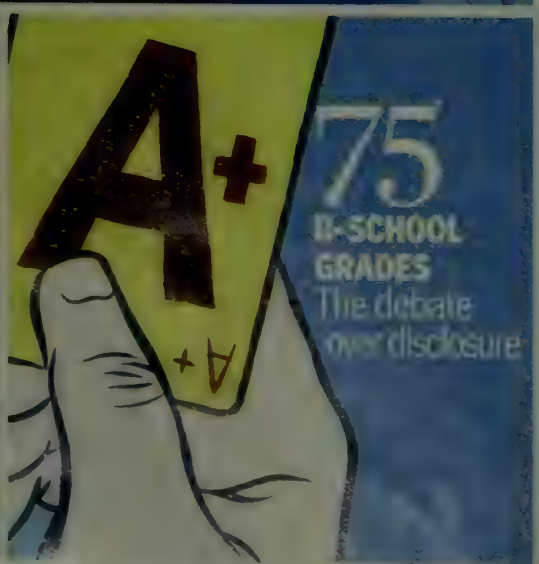

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Focusing on customers: it's one of the most powerful ways for businesses to boost their bottom line. A recent multi-industry study by the Wharton School, for instance, showed that reducing customer attrition by just 5% to 10% could increase annual profits by as much as 75%. And a survey by IBM found that the most important ingredient in the financial success of companies, registering twice the impact of product innovation and three times the impact of the firm's cost position, is customer relationships.

Getting To Know Your Customers

That's the good news. The bad news is that most companies know far less about their customers than they need to. Harvey Thompson, author of "The Customer-Centered Enterprise," reports from numerous surveys that "many companies simply do not have good input from their customers," and that almost none have customer information ideally suited to a successful relationship management effort.

Thompson and others suggest three key steps for correcting these shortcomings:

- Establish a customer-focused culture that explicitly focuses on customers' wants, needs, and overall experience.
- Consolidate customer information so that everyone who interacts with customers has a complete portrait of the customer's relationship with the company.
- Use technology to cost-efficiently make this customer information available across all customer touchpoints—in real time.

Translating Knowledge Into Profits

When these principles are put into practice, the results would make any CEO smile. Consider, for example, the case of BT Global Services, an $11 billion division of BT. Two years ago, BT Major Customers was convinced that growth within its unit serving networked IT services to large corporate customers was being imperiled by three [illegible]: slow reporting, restricted visibility into [illegible] interactions, and overlapping customer communications. The primary cause: limited access to consolidated customer information.

Recognizing this problem, BT [illegible] Customers promptly undertook a large-scale data consolidation initiative that refocused the company's processes around customers' needs. "Our goal was to make key business information visible in a user-friendly, timely manner," explains Steve Ackling, Director of Marketing, BT Major Customers. "We are now extending that reach into our Global Services operations."

The consolidation effort—which provided more than 7,500 sales, marketing, and service professionals with 360-degree views of the unit's 5,000 customers—paid off, with lead generation costs falling by a whopping 41%. Operational costs declined as well. "It used to take anywhere up to 10,000 person-hours to answer a question about the business," says Ackling. "I can now get most of the answers instantly."

Results Within Reach

BT Major Customers is not alone in achieving these phenomenal gains. A leading U.S.-based discount brokerage undertook a similar effort and quickly saw a 50% improvement in lead conversion, a 10% increase in customer retention, and a 67% increase in average revenue per sales representative.

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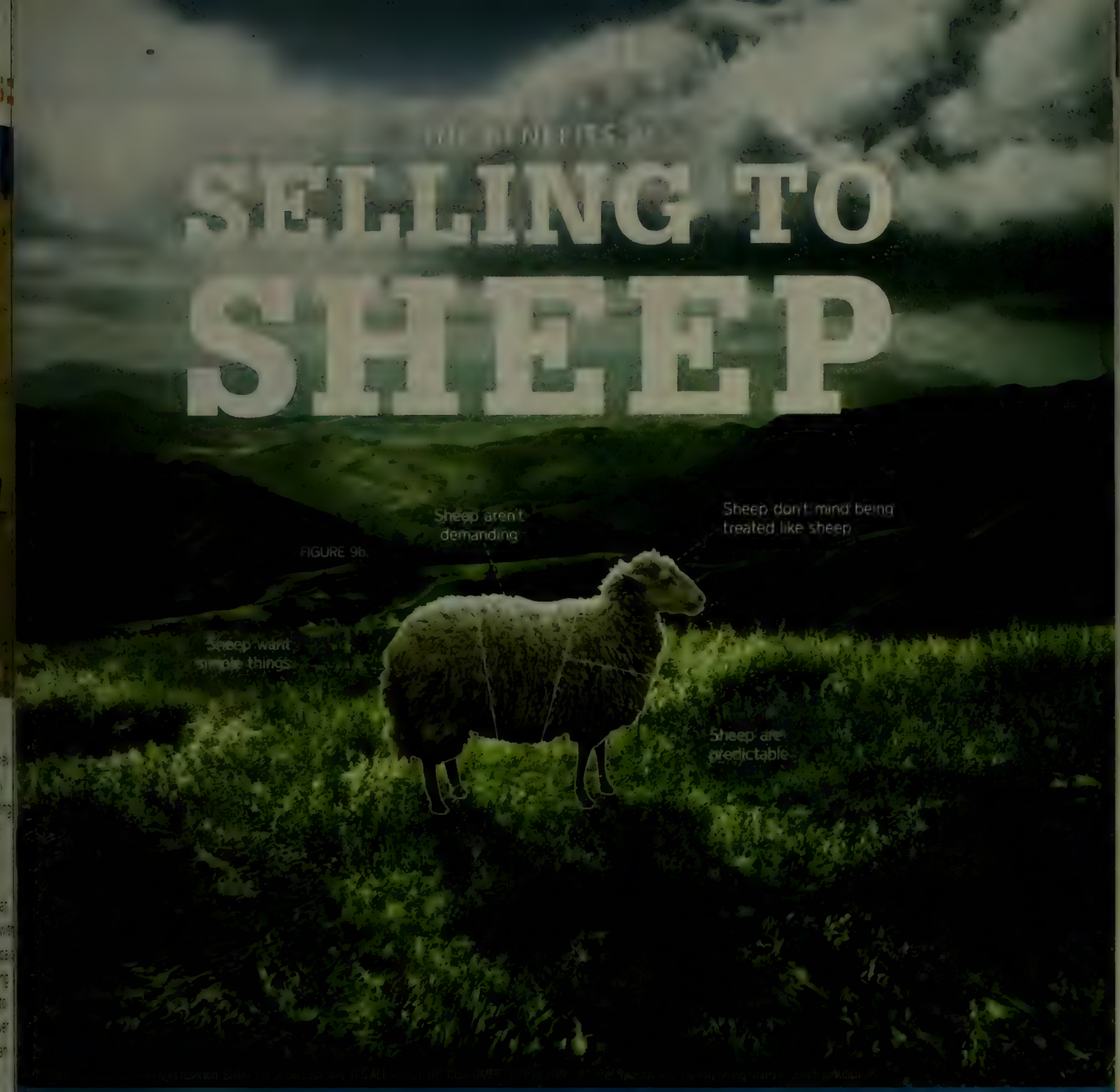

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Special Report: A Gallery Of Second Homes

So you've finally decided it's time to find a home away from home. Maybe you're a golf nut for whom nothing but a house **on the links** will do. Or perhaps a home **on the ski slopes.** Others prefer to be **near the ocean,** maybe to take the boat out. Speaking of boats, **living on one** is just the ticket for some folks, and for others a home **on wheels** is the best way to see the U.S., especially if you're retired and ready to roam. You'll find all these options explored in a series of slide shows, complete with pricing info

Meet BusinessWeek Online's Fittest CEOs

An elite group of top execs takes staying in shape almost as seriously as they do running their businesses. Plus: A slide show of some athlete-chiefs, such as sailor Larry Ellison, in action

Internet Mergers: Who's Next?

Dealmaking has returned to the Web sector with an intensity not seen in years, spurred by reasonable price tags on some of the smaller outfits. But the acquisitions may have only just begun

August Was Bad. September May Be Worse

Already on a downturn going into what is normally the roughest time for stocks, the markets could be facing a nasty spell ahead

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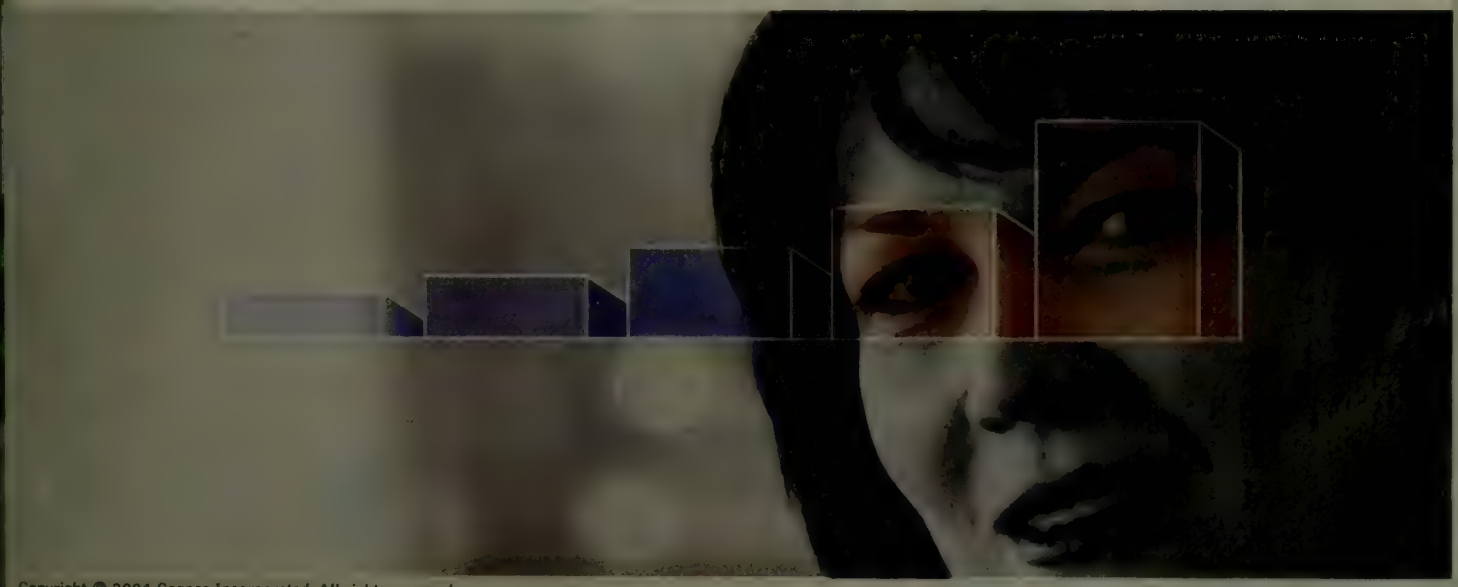

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THE RESILIENT INFRASTRUCTURE: A GUIDE FOR THE FEARLESS.

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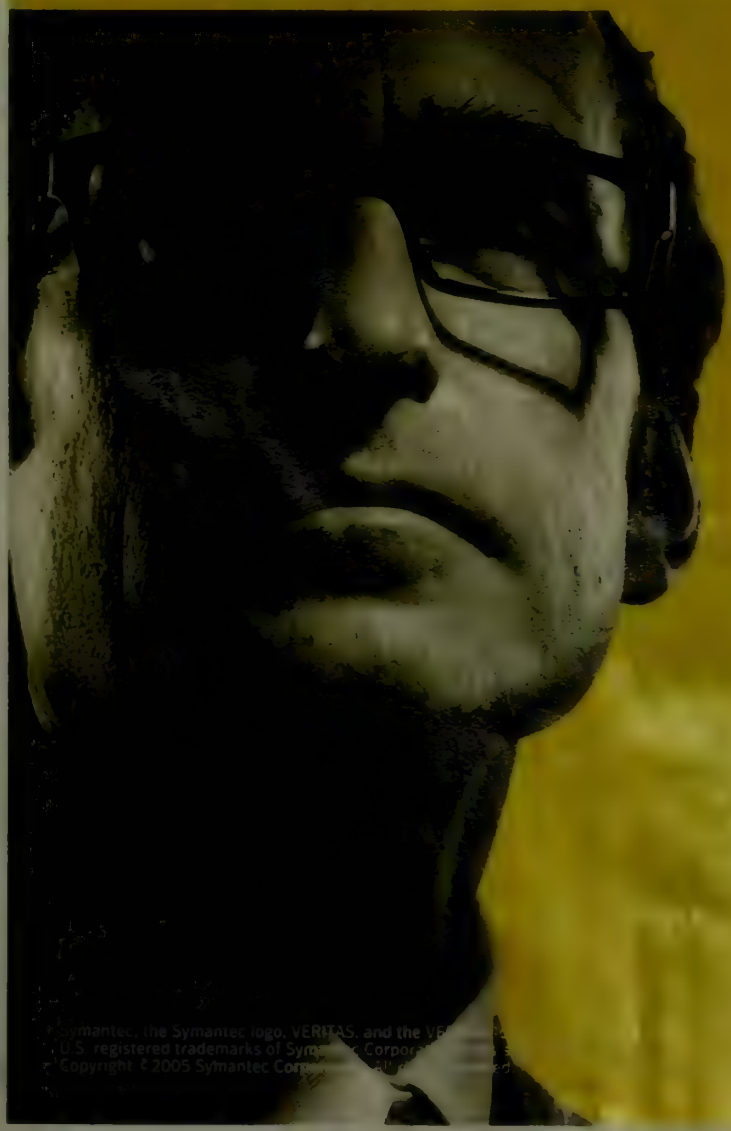

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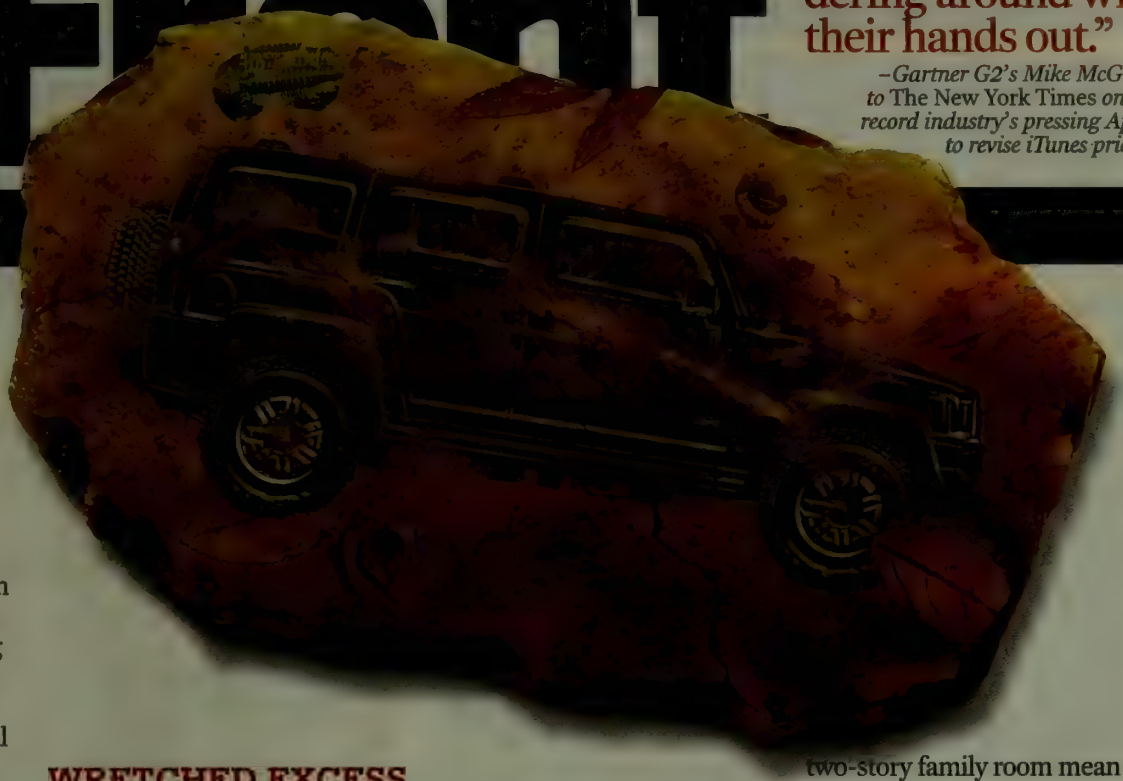
UP Front

"Three years ago these guys were wandering around with their hands out."

–Gartner G2's Mike McGuire to The New York Times *on the record industry's pressing Apple to revise iTunes pricing*

ITED BY DAN BEUCKE



ETROL PATROL

/HY COSTCO S ALL UMPED UP

E HOTTEST PRICE promotion **Costco** stores these days is eap gas. Costco is boosting ore traffic by getting shopers to line up for gas that's iced anywhere from several nts to 30¢ a gallon less an competitors'. At the stco in Woodinville, Wash., Aug. 30, regular gas was .59 a gallon, vs. as much as .77 at nearby stations, cording to **Gasbuddy.com**, a ice-comparison Web site. stco says it sold about $3 llion of gas in the fiscal year ended Aug. 28, up 30% from the year before.

The goal at the 227 U.S. Costcos fering gas is to beat prices at e five nearest gas stations, ys CFO Richard Galanti. stco keeps costs low by ving customers pay at e pump (you need a embership card, which costs 45 a year). That eliminates shiers. High volumes help, o: Stores often replenish eir gas supply daily. Meanhile, store traffic is climbing. f you've already got them in e parking lot, chances are ey'll run in to grab a rotisrie chicken for dinner," Galti says. Costco says that ery $1 spent at the pump nerates up to 40¢ in dditional sales inside the ore. *–Lauren Young*

WRETCHED EXCESS

End of the Road For Exurb Man?

RISING ENERGY COSTS could tame the expansive habits of Exurban Man. You know him—that prototypical consumer who bought into all the supersizing trends of the past decade: big SUV, big house, big commute. But as oil prices surge past $70 per barrel, is he headed for extinction? A back-of-the-envelope calculation shows a typical member of the species could face an extra $4,000 in yearly living costs.

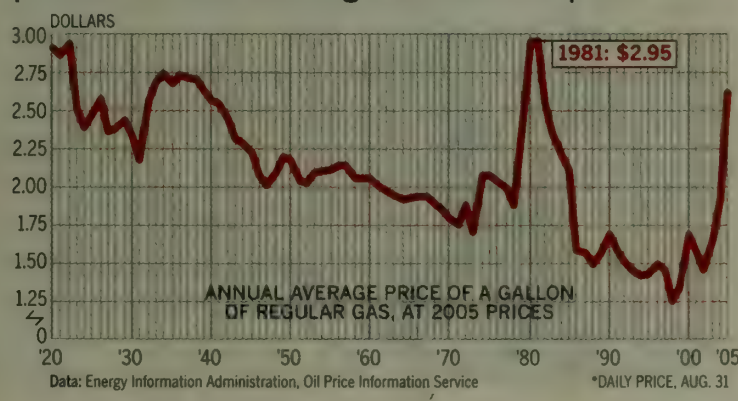
Enticed by the rugged image of the SUV, Exurban Man switched, let's say, from a fuel-efficient **Honda** Accord sedan to a stylish **Nissan** Pathfinder gas-guzzler. Shortly thereafter, he jumped on the housing boom and moved from the Chicago suburb of Oak Brook to up-and-coming exurb Yorkville, 55 miles away from his job in the Windy City. Much of the appeal of an exurb, of course, lies in its open space and larger lots. Exurban Man took advantage of the chance to spread out, trading in **Pulte Homes'** best-selling starter-size home in Illinois, the Pinebrook, for its popular 3,400-plus-square-foot model, the Scarborough.

Master of his castle, yes, but the new butler's pantry and two-story family room mean 1,650 more square feet to heat in the winter. With July natural gas priced at $9.71 per thousand cubic feet in the region, his heating costs will rise by $283 according to a conservative estimate by the **Energy Information Administration**.

Maybe the Pathfinder will navigate snow drifts better. But at 17 miles per gallon, vs. 28 for the Accord—and assuming $3-a-gallon gas and the longer commute—the SUV will eat $3,796 more in fuel per year. Not enough to send Exurban Man to the tar pits perhaps, but an incentive to adapt. *–Elizabeth Woyke*

THE BIG PICTURE

LONG VIEW With the recent runup, gas prices are now nearing their historic peak



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PRODUCT PEEK

THE NEXT BEST THING TO BEING THERE

IT'S THE RARE office worker who, locked in videoconferencing hell, doesn't fantasize about sci-fi fixes for disconnected voices, jumpy faces, and connection failures. But when CEO Jeffrey Katzenberg of **DreamWorks Animation SKG** got frustrated with the video link-ups to discuss his $100 million cartoons, he actually did something about it. DreamWorks teamed up with **Hewlett-Packard** to create a state-of-the-art system, the Virtual Studio Collaborator (VSC), that spared no expense to make workers hundreds of miles apart feel as if they were in the same room.

Encouraged by the results, HP has quietly been selling a scaled-down version of the system. While HP is mum about its specific plans, sources expect an announcement later in the year. Dubbed Halo, a single system costs slightly less than $1 million, sources close to the deal say, almost 10 times as much as a high-end custom conferencing system. But HP hopes to shake up the $5 billion videoconferencing industry with the smaller version of DreamWorks' VSC, the multiroom conferencing and data-sharing system that links that company's animation campuses in Los Angeles and Redwood City.

DreamWorks' VSC is to standard videoconferencing what Shrek is to the Katzenjammer Kids. Built in 2003 at a cost of "several million dollars," according to DreamWorks' Chief Technology Officer Ed Leonard, its twin conference rooms feature 14-ft.-by-20-ft. rear-projected, high-definition screens, high-powered lighting, sound isolation materials, and recording-studio-quality microphones and speakers. A standard high-end system swaps voices and images at 768 kilobits per second; the VSC rooms maintain a 30-megabit-per-second connection. The effect is disarming: Dreamworks execs in different locations interact naturally with uninterrupted discussion, while zooming in on drawings to see facial expressions and sce

HP licensed the te and already has 20 H up and running, says nard, including one a **vanced Micro Devices**. will stretch IT budget Leonard figures it pay itself through reduced costs for private jets, h and so on: "Companie justify the expense of t rooms in three flights."

–Robert La

DRAWN & QUARTERED

BOARD GAMES

WHERE ARE ALL THE ASIA HANDS?

CHINESE COMPANIES circle U.S. targets, while Americ eye deals on the mainland how well do U.S. boards u derstand the region? A stu of America's 100 largest companies by partners of recruiting firm **SpencerStua** shows a minuscule 1.8% of their directors are of Asian heritage. Only 2.3% have worked in Asia, run an Asia business, or worked directly for an Asian company. **Exxon Mobil, Pfizer,** and **Merrill Lync** are among those that fit the bill. "The rest risk making decisions in a vacuum," says Dennis Carey, the study's lea author.

–Emily Thornton

it moves, rolls, floats, orbits, rotates, sorts, lifts, measures, we can make it more energy efficient.

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UP Front

FACE TIME

LORNE ADRAIN

BARBECUES THAT BUILD TRUST

Insurance broker Lorne Adrain has made the neighborhood barbecue a national affair. Four years ago, when he fired up his grill for a block party in his East Side Providence neighborhood, it led to shared garden tools, a baby-sitter phone tree, even a key exchange. "We built trust," recalls Adrain, 51. Since then he has had surprising success spreading the simple idea of using barbecues to promote community involvement. He conspired with Harvard Business School classmates to create National Neighborhood Day on the second Sunday in September (Sept. 11 in 2005). His Web site (neighborhoodday.org) has downloadable invitations and party postings. This year Adrain expects nearly 10,000 related barbecues.

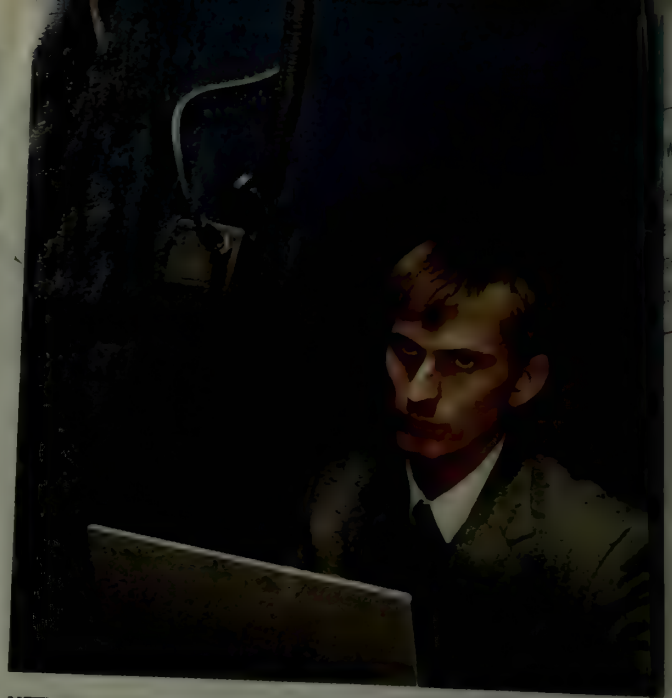
He recruited outfits such as Dell and Microsoft to promote the event through volunteer programs; CEO Tom Ryan of CVS is among his advisers. Employers see a low-cost way to support communities and workers. The food's not bad, either.

–Jessi Hempel

E-QUIPS

GOOGLE'S CRAFTY STAR SEARCH

GOOGLE'S REP for technology innovation is well known. But the Internet kingpin is also showing an inventive streak in human resources as it competes for an increasingly tight supply of search-programming talent. Google any of the following names: Udi Manber, head of **Amazon.com**'s A9 search subsidiary; Prabhakar Raghavan, **Yahoo!'s** research head; or Susan Dumais, one of **Microsoft's** top search researchers. The results page is adorned with a "Work at Google" ad. Such Google employment ads also surface on searches for names of many top academics in search, including W. Bruce Croft, who chairs computer science at the University of Massachusetts at Amherst.



NET ACE Google is watching

A bold move to snatch away top talent from competitors and academia? In a way, yes. But such Google ads also turn up alongside queries for big-name Google engineers, such as Adam Bosworth and Rob Pike. That indicates Google is less interested in going after these particular individ than in attracting folks have an interest in the o cited computing gurus. designed to go after the people looking to find us says Croft, who says suc have appeared next to hi name for "several month It's a novel recruiting tac Amazon.com serves up a similar ad alongside a co of these names, but Micr and Yahoo are nowhere t be found.

–Ben

O CANADA Flight Pass might save you cash

PLANE TALK

FOR FREQUENT FLIERS, A BOOK OF TICKETS

BULK BUYING is coming to airlines, courtesy of **Air Canada**. Travelers who fly between the U.S. and Canada can protect themselves from fare fluctuations—and perhaps save money—with the airline's new cross-border Flight Pass. If you fly a lot between New York and Toronto, for example, it can save you up to 30% compared with Air Canada's normal midprice fares. For $3,311, you can lock in 10 flights—five round-trips—good for 353 days. A trip that might run $780, before taxes and fees, costs just $662 under the program. But read the fine print. By booking well in advance or accepting less-desirable times, you might be better off without the pass.

Air Canada, thriving since it emerged from a restructuring last fall, has offered a domestic version of Flight Pass since spring 2004. **United Airlines**, an Air Canada marketing partner, is studying the program for the U.S.

–Joseph Weber

THE STAT

13

The percentage of big-company top executives who think having strong ethical values is the most important leadership trait needed by CEOs. That's down from 20% in 2003. Meanwhile, 37% cited the ability to inspire others, up from 22%.

Data: Christian & Timbers survey of 180 executives on July 11-18, 2005

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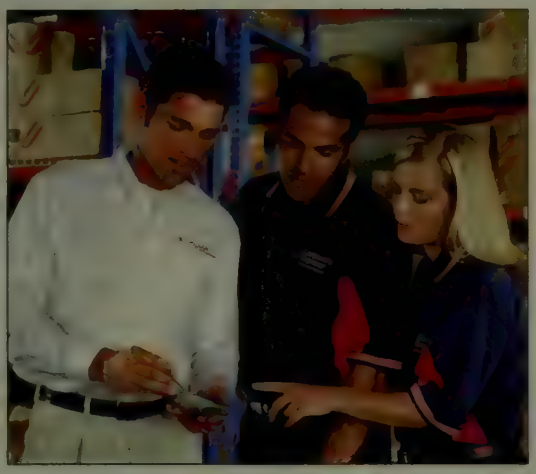

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> "Chrysler's return to profitability has been driven largely by...sharing components and designs with Mercedes."
>
> *–Lincoln Merrihew*
> *Boston*

BEGGING TO DIFFER ON DAIMLER—AND ITS PENSION PLAN

WHILE THE DaimlerChrysler merger may have not yet produced all the benefits everyone had hoped for, it has provided two pivotal ones ("Dark days at Daimler," Cover Story, Aug. 15):

1) Technology sharing: Chrysler's return to profitability has been driven largely by the 300 [sedan], which arguably would not be as successful without sharing components and designs with Mercedes. This opens the door for more sharing, and ultimately better (and globally requisite) economies of scale.

2) Global leadership training: Dieter Zetsche will be a better global leader for DaimlerChrysler as a direct result of his tenure in Michigan. This includes driving a turnaround, understanding the importance of product and marketing, and rapidly adjusting to new environs.

–Lincoln Merrihew
Managing Director, Automotive Practice
Compete Inc.
Boston

COME ON, FOLKS. Your article states that Chrysler's retirees have "saddled" the company with a pension plan that is underfunded. Do bankers "saddle" a company with debt? Do vendors "saddle" a company with invoices? Or do companies make decisions and incur risks to expend resources and incur obligations to obtain needed goods and services?

–Bill Tilden
Oakland, Calif.

THE SAVVY SELF-INTEREST OF DOING GOOD

RE "THE DEBATE over doing good" (The Corporation, Aug. 15). One of our key stakeholders is our people, and one of the benefits of contributing to the community is that it helps employees develop leadership skills and business acumen. What we have seen at Deloitte & Touche, which is reinforced by a recent external survey we conducted, is that volunteering offers people a way to develop the required leadership skills needed while also making a contribution to society. The survey revealed a strong link between volunteering and professional success. Among other findings, the data showed that 86% of employed Americans believe volunteering can have a positive impact on their careers; 78% see volunteering as an opportunity to develop business skills, including

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ReadersReport

CORRECTIONS & CLARIFICATIONS

In the table of contents in our Sept. 5 issue, Charles Davis was incorrectly identified as the CEO of Kraft. His title is vice-president of global technology and quality for convenient meals at Kraft Foods Inc.

In "Chuck Prince's Citi planning" (Finance, Sept. 5), we should have said that Steven Freiberg will oversee the bank's consumer operations in North America, and Ajay Banga will run the group internationally.

While Cummins Inc. financial statements report $8.4 billion in consolidated revenue in 2004 ("How Cummins does it," "China & India," Special Report, Aug. 22/29), the number is $10.7 billion when unconsolidated revenue from joint ventures is included. Also, the 2004 operating earnings of Cummins' joint venture with Dongfeng Motor in China was $86 million (not $89 million), and we should have clarified that Cummins' share was $43 million.

In "The art of fine dining" (Personal Business, Aug. 15), Wolfgang Puck should have clarified that he will provide catering for San Francisco's de Young Museum. He is not involved in operating its café.

In "Get creative!" (Special Report, Aug. 1), the graphic "Creative corporation toolbox" of innovation success rates in various industries used the "greater than" sign (>) when it should have used the "less than" sign (<). The correct rates are: toys (<1%), groceries (<2%), music (<2%), and computer hardware (<4%).

decision-making, problem-solving, and negotiating. Community service matters.

–James H. Quigley, CEO
Deloitte & Touche USA
New York

THE VIEW ESPOUSED by Milton Friedman and others that the role of business is to generate profits for shareholders is true, but only half the story. Stopping there begs the question: At whose expense are the profits generated? Without a social responsibility "governor," many businesses will externalize major costs of doing business to society at large until government or a group with adequate power steps in to say "enough is enough." Common external costs that were borne by society in the 20th century were health, food supply, and recreational losses associated with dirty air and water created to generate profit for shareholders in industrial enterprises. In the 21st century external costs are associated with global warming and extraction of nonrenewable resources. Businesses enjoy a tacit social license to operate. Any company or industry that jeopardizes that license will see its fortunes tumble.

–Neil L. Drobny
Columbus, Ohio

YOUR ARTICLE didn't mention the wide range of actions undertaken by Home Depot Inc. and other businesses to benefit currently serving military personnel and their families. Home Depot has many associates in the U.S. National Guard or the military services' Reserve components. When one of these associates is mobilized for uniformed service—there are some 1,800—Home Depot pays the difference between the associate's salary and his or her military pay. Home Depot also sends volunteer associates to the homes of those deployed to help families with repairs and maintenance and helps military spouses find jobs within the company when a spouse is moved to a new duty station.

–Vice Admiral Norb Ryan Jr., USN (ret.)
President
Military Officers Association of America
Alexandria, Va.

WHILE GENERAL ELECTRIC CO. plans to spend about $800 million more by 2010 on research and development of cleaner technologies, in the same time frame it also plans to increase its revenue by "at least" $10 billion from the same initiative, according to the company. I am sure none of GE's shareholders would mind this kind of return.

–Ashutosh Prasad
Plano, Tex.

THE CONNECTION between corporate social responsibility and the insuring of an improved future workforce is an important byproduct of involvement in improving conditions in central cities. Corporations would do well to include in their strategic planning a section that reads: "We need to reinvigorate our poorer communities so that we will have a competent future workforce that can compete successfully with the Chinese, Indians, etc., in the years to come." To clarify the discussion, let's substitute the term "corporate self-interest" for the words "doing good."

–Elmer L. Winter
Milwaukee
[illegible] writer is past president of [illegible]

IT SEEMS AT LAST that the boardrooms and corporate offices of corporate America are waking up to the reality of multiple and often powerful constituencies. Satisfying them entails far more than simply being a big donor or doing good deeds in the community. Who knows? Perhaps this dawning realization will lead to the widespread adoption of a "stakeholder scorecard" as a way for organizations to keep track of how they're doing in relation to their stakeholders. That might give Milton Friedman fits, but it would certainly benefit Corporate America and all of its constituencies.

–Fred Nickols
Howard, Ohio

EGAN-JONES SOUNDS OFF ABOUT THE SEC AND BUSINESSWEEK

"RANTING AT THE rating agencies" (Finance, Aug. 15) fails to provide balance for this critical area. The reason behind our Egan-Jones Ratings Co. "ranting" is the failure of the Securities & Exchange Commission to recognize us as a rating firm when 1) we provided warning to investors while the currently recognized rating firms did not, and 2) we are not paid by issuers and therefore do not have a conflict. Fundamental analysis has been and remains the core of our credit analysis (we review security price changes to assess firms' financial flexibility). You should have informed your readers that The McGraw Hill Companies financial services unit (which includes Standard & Poor's ratings business) has provided nearly all of your parent company's revenue growth over the past three years and accounts for two-thirds of its operating income of $1.2 billion per year.

–Sean Egan
Egan-Jones Ratings Co
Haverford, Pa.

Editor's note: The first paragraph of the story disclosed that *BusinessWeek*, like Standard & Poor's, is part of the McGraw-Hill Companies.

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Technology&You

BY JAY GREENE

A Sharp-Shooting Camcorder

For home moviemakers of old, it was enough just to capture your baby's first steps or your daughter's wedding. It didn't matter whether you shot in Super 8 film or Hi8 video—you just wanted some way to relive those moments. But with Sony's new high-definition camcorder, the HDR-HC1, the scene may actually play second fiddle to the picture quality.

FROM SONY FOR $2,000

This is the first high-definition camcorder aimed at the consumer market, and with a list price of $2,000, it may be pushing the limit for many families. But just as expensive high-definition TVs are winning converts among folks who never once complained about ordinary TV picture quality, HD cameras could prove alluring.

Unlike professional HD cameras that you have to hoist over your shoulder, the HC1 looks and feels just like any other camcorder. Weighing just 1 lb. 7 oz., the barrel-shaped device fits in a coat pocket and can be whipped out at a moment's notice.

Of course, there still aren't any consumer DVD or video players that can show the high-definition footage you shoot. Sony takes care of that by letting you connect the HC1 directly to the red, blue, and green component jacks on the back of your HDTV set. Then you can play back the HD video that the camera has recorded on standard MiniDV or DV tapes. I watched my masterpieces on a Philips HD set I bought a year ago, and I marveled at the flawless images.

This camcorder has all the features most consumers would want, controlled through a 2.7-inch LCD touch screen that flips out from the body. You use the screen as a viewfinder, then scroll through different choices on the menu, such as fading in and out, or adding sepia tones. The battery lasts for a remarkably long 90 minutes.

THE HC1 WON'T BE IDEAL FOR EVERYONE. Videophiles may carp about its having only one image sensor rather than three, as on high-end HD cameras. This can sometimes produce grainy shots in low-light situations.

Another concern is how to store your home movi[illegible] long term. Sony, Toshiba, and other tech companies a[illegible] battling over the standards for high-definition DVDs, w[illegible] will eventually supplant today's digital videotapes for HI[illegible] recording. Sony and its tech allies are pushing a format ca[illegible] Blu-ray and sources at Sony anticipate that it will be easy to burn HD footage onto a Blu-ray disk—as long as you purchase the burners and blank disks. B[illegible] if a rival format known as HD-DVD takes root instead of Blu-ray, owners of Sony's HD camcorders may be stuck forever plugging their cameras into HDTV sets.

For now, the bigger headache is editin[illegible] Don't bother trying to do this on the camera itself. Because the image are on tape instead of a disk medium, there's no way to splice together two scenes shot at different times without first moving those videos to a PC. An without that step, you can't overlay music to play in the background of your home movie

> Sony's HC1 is high-def—but editing can be a challenge

Even editing on a personal computer is a challenge. While Apple Computer offers inexpensive tools for editing HD video, Windows users are stuck with much more expensive software, geared to professionals—at least until this fall, when consumer software will arrive. The two programs I tried—Ulead's $300 MediaStudio Pro 7 and Sony's $600 Vegas 6 software—produced some nifty effects. Using the program however, was far from intuitive. And when the editing is done, you still have to upload the finished product onto digital tape to view it on a TV.

Headaches aside, the videos are spectacular. My family doesn't have a new baby whose every move we want to document, but we did just get a puppy, and I was there, HC in hand, for her first bath and the first time she sat on command. I can't swear that high-definition is what make these little movies so powerful. But it sure doesn't hurt. ■

[illegible] Steve Wildstrom is on vacation. For a collecti[illegible] and online-only reviews of technology products, go to Tec[illegible] at www.businessweek.com/go/techmaven/

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1995 - 2005

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MediaCentric

BY JON FINE

Media, Marketing, and Advertising in the 21st Century

Local TV's Brave News World

Imagine a world in which local TV news doesn't suck. I know, I know. It's not easy. But try. ¶ Imagine an end to pointless news-chopper one-upmanship, to "breaking" reports on trumped-up consumer scams, to the same-show-different-anchors feeling that viewers get nightly from West Palm Beach to Walla Walla. ¶ "We all get the same research" that viewers find the TV news format tedious and irrelevant, says Michael Sechrist, president of Nashville's ABC affiliate, WKRN. "And we shake our heads, say, 'Yeah, yeah,' and we don't do anything."

Except Sechrist is. WKRN is retraining its staff in shooting and producing digital video in a bid to radically transform its on-air product. If what WKRN does works, it will be Exhibit A in proving that local TV news can retool itself to regain its audience in a fragmenting media landscape.

Guiding WKRN is Michael Rosenblum, the veteran TV producer-cum-consultant behind a video-production model that's often abbreviated to "VJ," for video journalist. In a VJ operation, your entire staff—not just reporters—can shoot stories. Your entire staff—not just the editors—can edit news segments, even on laptops while out in the field. You break the old dependence on an operation's (few) camera crews. In theory, you get more naturalistic programming—think "documentary film," not "reporter stands stiltedly in front of building"—since you don't have to pose and light everyone just so before filming with obtrusive gear. More people producing stories, ideally, equals a wider array of subjects. Rosenblum says the VJ model also can slash costs up to 60%. (He concedes that layoffs and union issues could result.) One recent VJ convert: the BBC. An exec says going VJ increased the BBC's cameras in the field from 84 to over 1,000. On deck: San Francisco's KRON (owned, like WKRN, by Young Broadcasting). WKRN's staff is to be fully retrained by mid-September.

THE HOPE IS THAT MORE VIEWERS, especially younger ones, will watch. WKRN's news ratings trail others in Nashville, so it has freedom to experiment. But all stations should feel so free. Like a Sunday paper, local news contributes disproportionately to station revenues; like broadcast TV, it's in a decline. Terry Heaton, another WKRN consultant, studied late-news ratings over 10 years in six midsize and metro markets. Total drop: 30%.

The VJ model hits TV news at a particularly plangent cultural moment. Al Gore's Current network—for which Rosenblum consulted—is presenting news in a manner that's heavily influenced by new media. A small coterie of media hotshots-turned-bloggers—among them Jeff Jarvis, ex-president of Newhouse Newspapers' online unit and ex-*San Jose Mercury News* columnist Dan Gillmor—is talking up sundry "citizen journalism" initiatives. Such efforts are now sprinkled across the globe, from Southern California (northwestvoice.com) and southern Vermont (ibrattleboro.com) to South Korea (ohmynews.com).

> Can "video journalists" and "citizen journalists" lead TV out of the abyss?

In the broadest possible terms, these seek to put the tools of reporting and storytelling into the hands of an entire community, rather than concentrate them within newsrooms. (That bloggers' accounts of Katrina's devastation became part of the media diet marked another seminal citizen-journalist moment.) These are exciting developments, unless you work in traditional media. If your business is democratized, are you democratized out of business?

What happens with WKRN will provide early insight into how well this democratization—with all its delicious tinges of empowerment—can work in a mass-market business model. WKRN also trained local bloggers in video production, so they too may contribute news segments. Plenty of big-name players are tinkering around the edges with citizen-journalism. It's harder to find a major-market network affiliate making such a far-reaching effort. Says Sechrist: "We are not going to go back." No pressure, Michael, but the media world is watching. If it works, we might start tuning in at 11 again. ■

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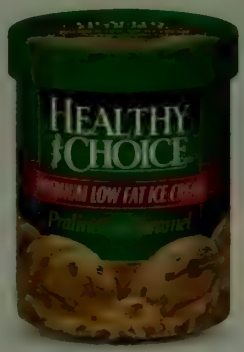
The Barker Portfolio

BY ROBERT BARKER

A Dividend Too Rich to Last?

Is any big stock today more hated than ConAgra Foods? Are many as tempting? None of the nine analysts tracking this maker of Healthy Choice dinners and snacks, Butterball turkeys, and more rates it a buy. At the same time, ConAgra offers a 4.8% dividend yield, among the richest in the Standard & Poor's 500.

Contrarian opportunity or trap? Only last January, shares of ConAgra topped 30. Lately, they have dipped near 22, a level not seen since 2003. And for some good reasons. Bruce Rohde, chief executive since 1997, has failed to raise profits in recent years, with earnings per share in fiscal 2005, ended in May, coming in at $1.23, 2¢ below the 2001 level. Many of ConAgra's dozens of brands—Wesson or La Choy, not to mention Van Camp's Beanee Weenee—are cold properties. The outlook for overall sales growth remains tepid at best. Worse, the company this year had to restate past earnings reports to increase its tax expense by a total of $105 million over three and a half years. This was the result not of some misdirected technical judgment, but what ConAgra calls "a material weakness in internal control over accounting for income taxes." This went on even as ConAgra has been negotiating a settlement with the Securities & Exchange Commission over a different set of accounting problems from back in 2001.



MOTLEY BRANDS ConAgra's sales growth is sluggish

NOW DIRECTORS ARE LOOKING for a successor to Rohde, who asked them to do so in May. He is set to face shareholders at the Sept. 22 annual meeting. Last September, ConAgra raised its dividend for the 30th straight year, to $1.09 annually. That started me wondering: Will the streak end there? A company spokesman told me only that ConAgra's board appreciates the payout's importance and believes that ConAgra has the resources to meet it, along with such other demands as debt payments and reinvestment in the business.

What's so today, however, may not be tomorrow. To see what I mean, start by looking at ConAgra's cash flows (table). In fiscal 2005, the company collected revenue of $14.6 billion. From that, it counted $837 million in cash from continuing operations and spent $453 million in capital expenditures. That left $384 million, but dividend payments to common shareholders came to $550 million. How did it fill the gap? By selling assets, such as shares of poultry processor Pilgrim's Pride. All told, asset sales raised cash of $607 million. That, plus cash from discontinued operations, cash from exercises of employee stock options, and cash on hand allowed ConAgra to also pay off $1.2 billion in long-term debt and to repurchase $181 million in stock.

How might ConAgra cope in the future? Assume it keeps its dividend at $1.09 a share. That implies a $565 million outlay, which with the $400 million it has budgeted for capital projects, comes to $965 million, or 15% more than operations produced last year. The company expects first-quarter profits to fall below last year's level, but let's assume generously that fiscal 2006 operating cash flow rises 10%, to $921 million. That still would fall $44 million short of the tab for capital spending and dividends.

ConAgra's Pricey Payout

KEY SOURCES OF CASH		KEY USES OF CASH	
Cash Flow from Continuing Operations	$837	Capital Spending	$453
One-time asset sales	607	Dividends Paid	550
TOTAL	$1,444	TOTAL	$1,003

All data for fiscal 2005, ended May 29, in millions

Data: Company reports, BusinessWeek

Fortunately, ConAgra was able in August to sell the rest of its Pilgrim's Pride stake for $482 million. After taxes, that should leave enough for capital spending, dividends, and repayment of the $117 million in debt coming due this year. Next year, though, an additional $519 million in debt is due. ConAgra wants to liquidate $147 million in notes it holds from the 2002 divestiture of its fresh-meat operations, but when I asked, the company did not point me to other assets that might be sold for cash.

At 4.8%, ConAgra's dividend yield sticks out. Sara Lee (4.1%), H.J. Heinz (3.3%), Kraft Foods (2.9%), General Mills (2.8%), Campbell Soup (2.3%), and Hormel Foods (1.7%) all pay noticeably less. How would Rohde's eventual successor size this up? Probably in three words: Cut the dividend. A fair argument might be made that a lower dividend already is priced into the stock. But with ConAgra trading at 16 times this year's earnings, just a bit below its better-fixed rivals, I'd rather let other investors take that bet. ■

E-mail: rb@businessweek.com

Y JAMES C. COOPER & KATHLEEN MADIGAN

Why Growth Could Still Stay on Track

Strong profits and cash from faster job gains will help the economy cope

U.S. ECONOMY Throughout the summer, rising energy prices were he major topic of any discussion of the economy's future. Now, Hurricane Katrina has added her own stamp on the outlook for the econd half. Residents of Louisiana, Alabama, and Mississippi are still allying up the human and financial losses, as Katrina could shape p to be the costliest hurricane in U.S. history.

Unlike the demand-driven surge in oil prices before atrina, a supply shock could be more damaging if rilling and refinery production is severely curtailed. Pre-urricane gasoline prices held steady at $2.61 per gallon n Aug. 29, but the jump in crude prices—they climbed to ver $70 per barrel after the hurricane hit land—suggests ore increases are on the way. Forecasts generally ssume a modest disruption to refining output, causing nly a temporary rise in energy prices. And on the plus de, rebuilding will offset any drop in demand caused by ore closings and business losses (page 32).

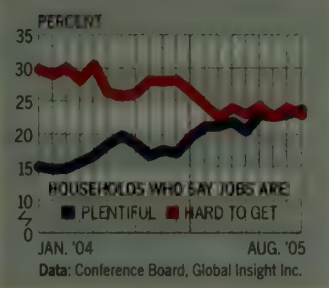
Even before Katrina, higher energy costs were already aving a negative impact, the biggest burden falling on wer-income families and transportation-related ndustries such as trucking and airlines. And the Federal eserve noted at its Aug. 9 policy meeting, according to e minutes, that higher energy prices were "likely to be a gnificant drag on consumption." After charging into the ird quarter with a full head of steam, helped in large art by the steep discounting among auto makers, emand is probably easing right now and will end the ear at a more moderate pace.

But bear in mind that real gross domestic product in e third and fourth quarters will probably grow close to e 3.6% annual rate averaged in the first half. That eans, in a year when oil prices may average close to $60 barrel, real GDP will very likely advance by about 3.6%. hat would be down only a bit from the 3.8% pace in 004, when oil prices averaged $41.

To be sure, if the damage to oil refineries is extensive nough, the price of gas could head even toward $4 per allon and exert a severe drag on consumer spending and ttle business confidence. But unless that occurs, the rux of the outlook is this: As long as companies are aking money, spending it, and hiring more workers, is economy seems set to withstand the impact of day's higher fuel prices.

HAT EXPLAINS THE RESILIENCE? The abundance of ash coming from faster job growth and strong profits is nabling the economy to cope. Income growth is solid nough to cover the extra energy bills for the consumer sector overall, and homeowners continue to tap into their home equity to finance big-ticket purchases. That's why consumers are willing to snap up a bargain, whether it be a new car or back-to-school denims. Plus, corporations are sitting on a boatload of cash, thanks to double-digit earnings growth. So they are moving ahead to rebuild inventories and complete capital projects.

THE JOB MARKETS RULE CONSUMER ATTITUDES



Data: Conference Board, Global Insight Inc.

Also, financial conditions remain accommodative. Despite the Fed's hikes in short-term interest rates, bond yields remain low. The yield on 10-year Treasury notes has fallen from 4.4% on Aug. 8 to barely above 4% on Aug. 31, a drop that will support housing and refinancing activity. The cost of borrowing, whether for a new home or a new warehouse, is cheap, and banks are eager to lend.

TO SEE HOW ENERGY is affecting households, just look at the Conference Board's report on consumer confidence. Its August index rose to 105.6, from 103.6 in July. Expectations for the next six months rose, but the bigger gain was in the assessment of current conditions. That index jumped from 119.3 to 123.6, a four-year high.

The rise in confidence defies conventional wisdom that sticker shock at the pump should be dimming consumer spirits. But the board's report supports the notion that the labor markets are far more important to consumers than the price of energy. And the board said that households view the employment picture as "upbeat." The percentage saying jobs are plentiful rose to 23.5% in August from 22.9% in July, while the percentage who think jobs are hard to get slipped to 23.2% from 23.8%. This was the first time since October, 2001, that more consumers thought jobs were plentiful than those who said they were scarce (chart).

Confidence is sure to dip in September, given the

aftermath of Hurricane Katrina and the further jump in oil and gasoline prices. Spirits sagged last September and October after the South was hit by four hurricanes in quick succession.

In fact, Katrina will probably skew much of the data for September and beyond in a manner similar to last year's patterns. Store and factory closings could hold down retail sales and industrial production in September, but then the rebuilding effort will probably boost sales and production, including residential construction, later on.

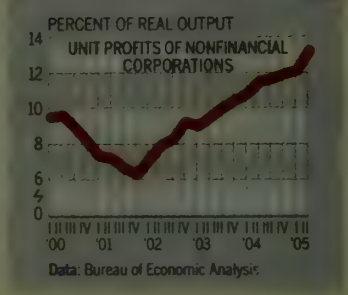
The foreign-trade data will also be affected since the ports in the flooded areas around the Gulf of Mexico handle about a third of U.S. export and import volumes.

FROM AN ECONOMIC STANDPOINT, the biggest impact from the hurricane is likely to be a swing in corporate profits. Economists at Capital Economics Ltd. point out that last year's hurricanes subtracted $23.3 billion in profits economywide, comprising uninsured losses to businesses as well as net insurance settlements. Some early estimates of the damage from Katrina's fury are already greater than that.

A third-quarter drop in profits will follow a double-digit gain posted in the second quarter. The latest numbers from the Bureau of Economic Analysis show that corporate profits from current production rose 17.7% from the previous year, and profit margins of nonfinancial corporations expanded further (chart). Earnings are strong because demand in the second quarter was equally robust. Revisions to the data show real GDP grew at an annual rate of 3.3% last quarter, close to the originally reported 3.4%.

As the third quarter began, companies were using the profits to beef up lean inventories and to expand and modernize operations. Manufacturing inventories rose 0.5% in July to a four-year high. But stockpiles are still not excessive given the rapid pace of factory sales, a plus for orders and production in coming months.

PROFIT MARGINS CONTINUE TO WIDEN



Ordering and output will increase, however, only as long as companies believe demand will stay strong. The new danger is that Katrina could throw a damper on executives' assessments of the economy's future performance.

This uncertainty adds to the risk that corporate caution could exert a powerful drag on the economy beyond the fourth quarter. Just as in brief instances in 2003 and 2004, hesitancy among companies worried about demand could cause businesses to scale back or delay their spending and hiring. Weak job growth would then cause consumers to shop less and save more. To the extent that scenario plays out, it could rob the economy of momentum heading into 2006. ■

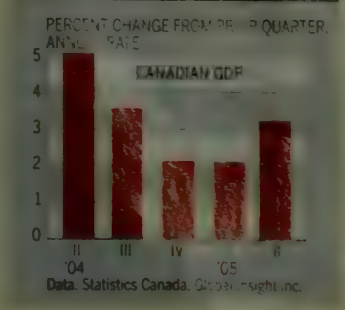
CANADA

Gingerly Tightening Monetary Policy

LAST YEAR the Bank of Canada took monetary policy on a tricky maneuver. It kept its target interest rate at an unusually low 2.5% to buoy the trade-sensitive economy, which was straining under the weight of a 25% rise in the Canadian dollar. So far, so good. Based on the Aug. 31 report on second-quarter gross domestic product, the economy is firming up nicely.

Now comes the hard part: Finding the level of interest rates that will prevent the economy from overheating and keep inflation under control. By the bank's own metrics, the economy is already operating perilously close to full capacity, and growth is set to accelerate in the second half to a pace that will most likely breach those bounds.

GROWTH BEGINS TO ACCELERATE

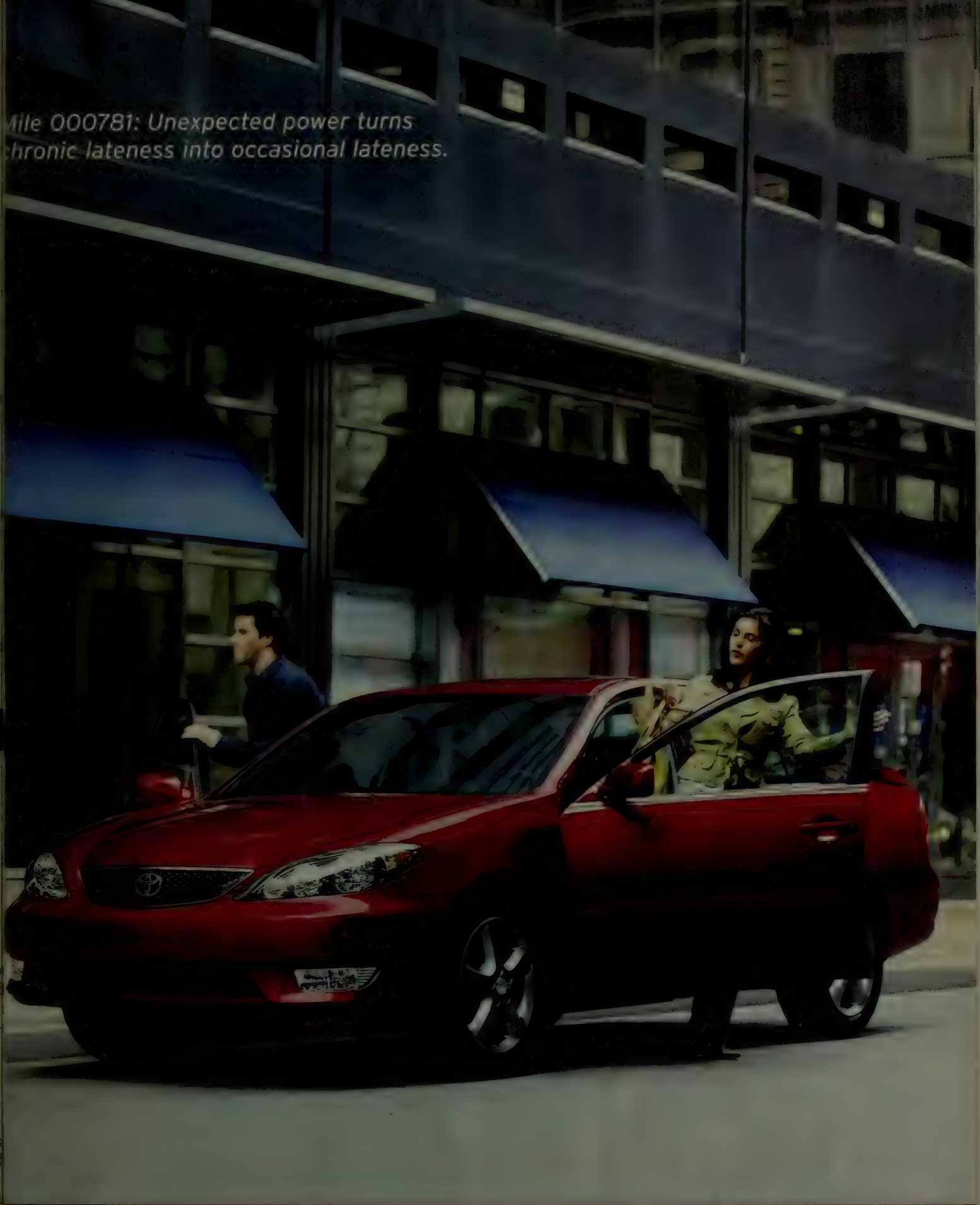


Real GDP grew at an annual rate of 3.2% last quarter, up from 2.1% in both the first quarter and last year's fourth quarter. But those modest numbers mask continued robust growth in domestic demand, which has advanced at an annual rate of 4.5% over the past three quarters. The top-line GDP numbers reflect the deteriorating trade balance in the fourth and first quarters and a sharp slowing in inventory growth in the first and second.

By the second quarter, however, an improving trade balance had begun to contribute positively to growth, and the currency restraint continues to ease. Moreover, the biggest drag on second-quarter GDP was a second consecutive slowing in inventory growth. Strong demand by consumers, businesses, and the government combined with lean inventories leaves the economy set for output to speed up in the second half.

That pickup would come at a time when unemployment is close to a 30-year low and the factory operating rate is near a 30-year high. Costlier energy has already pushed air fares up sharply, and the latest surge in oil prices will add to the pressure on businesses to pass along higher costs.

The BOC, which is widely expected to begin lifting rates on Sept. 7, has a problem much like that of the Federal Reserve in the U.S.: It must normalize rates, which have been overly accommodating to demand. But because the Canadian economy is already wound up so tightly, the BOC has a smaller margin for error. ■



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44 Daunting challenges in the Big Easy
46 Making sense of the mess at KPMG
50 The promise of a new AIDS drug

KATRINA'S WAKE

In addition to the hurricane's human toll, damage to the nation's energy infrastructure could reverberate well into the future

BY PETER COY AND DEAN FOUST

SAVED Henry Rhodes on Aug. 29 after his rescue by the New Orleans Police Dept.

DAYS AFTER ITS HOWLING WINDS died away, Hurricane Katrina continued punish the people unlucky enough to have been in its path. Initially u derestimated, the storm that slammed into the Gulf Coast on Aug. 29 le hundreds of thousands of families homeless and hundreds—and possib thousands—more dead in and around New Orleans. Parts of the Mississip coastline were nearly swept clean. In New Orleans flooding worsened

breached levees gushed water into the city. The Big Easy has become a toxic soup bowl, with looters roaming the flooded streets and residents airlifted from rooftops. "We are dealing with one of the worst natural disasters in our nation's history," said President George W. Bush, who flew over the stricken region on Aug. 31.

Now it's becoming clear that Katrina's economic impact, too, will be more severe and far-reaching than first thought. Certainly, the estimates of insured losses are enormous—indeed, they could easily top the record of $21 billion set by Hurricane Andrew in 1992, according to Robert Hartwig, chief economist at the Insurance Information Institute. But the estimate actually understates Katrina's impact. That's because the property damage in Katrina's direct path, however painful for the region's residents, represents only a small part of the harm inflicted by the hurricane. More significant—and harder to measure—is the damage to the national economy caused by soaring energy prices and shipping disruptions.

What makes Katrina different is that it wasn't a strictly local disaster. It pummeled the nation's all-important energy infrastructure as well as the main shipping channel of heartland America. The Gulf accounts for 17% of the country's refining capacity and one-quarter of its daily crude output. Much of U.S. imports of Saudi Arabian oil pass through Louisiana. "You have a major energy network that is down, and it is not clear when it can come back up," says one pessimist, Roger Diwan, a senior analyst at PFC E ergy in Washington. "We could run out gasoline or diesel or jet fuel in the n two weeks here."

The damage to the energy and tra

What Now?

Until the extent of the damage the oil-and-gas sector is know it will be difficult to assess the hurricane's long-term econom impact. Here are three scenari ranging from best to worst:

WASHED ASHORE Katrina hurled an oil rig onto Dauphin Island, Ala., and left boats, RVs, and shipping containers clogging a residential area of Gulfport, Miss.

ortation infrastructure comes at a time hen the country can ill afford any disiption. Prices of oil, natural gas, and asoline were already at record highs, nd producers were running flat-out to atisfy demand. "This is going to keep nergy markets on a razor's edge for the est of the year," predicts Mark Zandi, hief economist at Economy.com Inc., a Vest Chester (Pa.) forecasting firm. The urricane "is taking what was shaping p to be a good second half and turning into a big question mark." Nariman ehravesh, chief economist at Global Insight Inc. in Waltham, Mass., is predicting growth of around 2.7% in the fourth quarter, roughly half a point lower than he expected before the storm. In the worst case, he fears growth could slow to below 1%.

How bad will Katrina be for the U.S.? Much depends on the severity of the damage to the oil, electrical, and transportation infrastructure—something that was impossible to assess as *BusinessWeek* went to press, with much of the region still out of communication with the outside world. Says John C. Felmy, chief economist at the American Petroleum Institute: "Offshore, we're just barely out to fly over and find out which platforms are safe to board. Then we have to inspect, which means sending down divers. Helicopters are in short supply. It's impossible to estimate when production will be back."

The U.S. Minerals Management Ser-

	BEST	MIDDLE	WORST
BAD ?	Damage to offshore platforms and undersea pipelines turns out to be minimal. Power to refineries and ports is quickly restored. Shipping through New Orleans resumes. The race to rebuild puts more people to work, boosting growth.	Some refineries and rigs remain offline well into the fall. Supplies remain tight, though no serious shortages of gasoline or natural gas emerge. Higher energy bills dent corporate profits and force consumers to tighten their belts.	Extensive damage to the regional energy, electricity, and communications infrastructures causes energy shortages and disrupts shipping and production. Consumers pull back sharply, while companies, unable to pass on rising costs, take big earnings hits.
HE P	After spiking to a national average of a little above $3 nationally, gasoline retreats to below $2.50 gallon.	Retail prices stay above $3 a gallon for weeks or months, up from $2.60 before the hurricane.	Gasoline soars to a previously unthinkable $4 a gallon, and in many cities long lines form at the pump.
TOM	GDP increases 4% in the fourth quarter, up from the expected 3.5%.	GDP growth slows to a disappointing 2.7% in the final quarter.	The fourth quarter is a write-off, with 0% growth. Recession threatens.

(L TO R) JAN-MICHAEL STUMP/THE BIRMINGHAM POST-HERALD; PAUL J. RICHARDS/AFP/GETTY IMAGES

REUNITED Elizabeth Duvall and son Dustin in their East Biloxi (Miss.) neighborhood

vice said that as of Aug. 31, 92% of oil production in the Gulf of Mexico was still shut down. Nine refineries accounting for about 9% of U.S. output were not operating, and most were likely to remain out of service for weeks. All of the major railroads closed down traffic in and out of the region. Interstate 10, a vital highway that runs clear across the South, was severed.

Even if the refineries are relatively undamaged by the winds and flooding, a trashed electricity grid could prevent them from coming back online anytime soon. A lack of power also shut down pipelines that ship gasoline and other products from the Gulf to the Northeast. There was some good news on Aug. 31: Colonial Pipeline Co. restored enough power to start pushing gasoline through part of its 5,500 miles of pipeline, which stretch from Houston to New York. Colonial expected capacity to reach 50% to 60% by the weekend. But Entergy Corp., which serves Louisiana, said it will take "weeks" to fully restore electricity, noting that 150 substations were destroyed or damaged. And the utility said it can't afford to give top priority to getting power back to the refineries. Tops on the list are hospitals and emergency services, a spokesman says.

Already, spot shortages of gasoline and diesel supplies have emerged at wholesale terminals, according to Dan Gilligan, president of the Petroleum Marketers Assn. Says Gilligan: "It's worse than tight. It's a total domino effect all throughout the infrastructure."

A BOON FOR BANKS

SOME PARTS OF THE country are already starting to hunker down. Florida gets most of its natural gas for generating electricity from Gulf of Mexico production wells that were shut by the hurricane. On Aug. 31 the state's power-grid monitor ordered utilities to line up emergency backup power and curtail power to customers who have interruptible-supply contracts. Meanwhile, as far away as Connecticut, line at the pump grew as people filled their tanks in fear of shortages and rising prices. That of course, only makes matters worse, says Amy Myers Jaffe, a fellow at the James A. Baker III Institute for Public Policy at Rice University: "If everybody in America fills their tank, [the added consumption] could be in the millions of barrels a day. You want to do the opposite. If everybody in the country filled their tank only halfway, it puts less strain on the supply system."

The question, of course, is whether these will prove to be short-term blips or whether they herald the start of more serious problems. In the best-case scenario, damage to the energy, power, and communications infrastructures will turn out to be fairly light and the spike in energy prices temporary. In that case, GDP growth in the fourth quarter could actually come in higher than previously expected thanks to the stimulative effects of reconstruction spending.

Indeed, some industries will benefit once the rebuilding process begins. "From a bank's perspective...it's good economically in the same paradoxical way that a war is good economically for a lot of people," says bank research analyst Eric Reinford of SNL Financial in Charlottesville, Va. "Natural disasters historically have been a boon for banks because they'll be lending and speeding up the processing of loans." Other big winners are construction companies and building-materials makers. Stocks of those companies have soared.

In the worst-case scenario, though, it will take months to get Gulf production and refining back into full swing. That could lead to regional shortages of gas and other fuels and could send oil prices soaring to $90 a barrel or more for an ex-

A Flurry of Price Jumps

Hurricane Katrina pushed already-lofty wholesale energy prices in the futures market even higher

	GASOLINE (Price per gallon*)	NATURAL GAS (Price per million BTUs)	HEATING OIL (Price per gallon*)
AUG. 24	$1.93	$9.98	$1.87
AUG. 31	$2.61	$10.85**	$2.05

*Contracts for September delivery
**Aug. 29 close
Data: New York Mercantile Exchange

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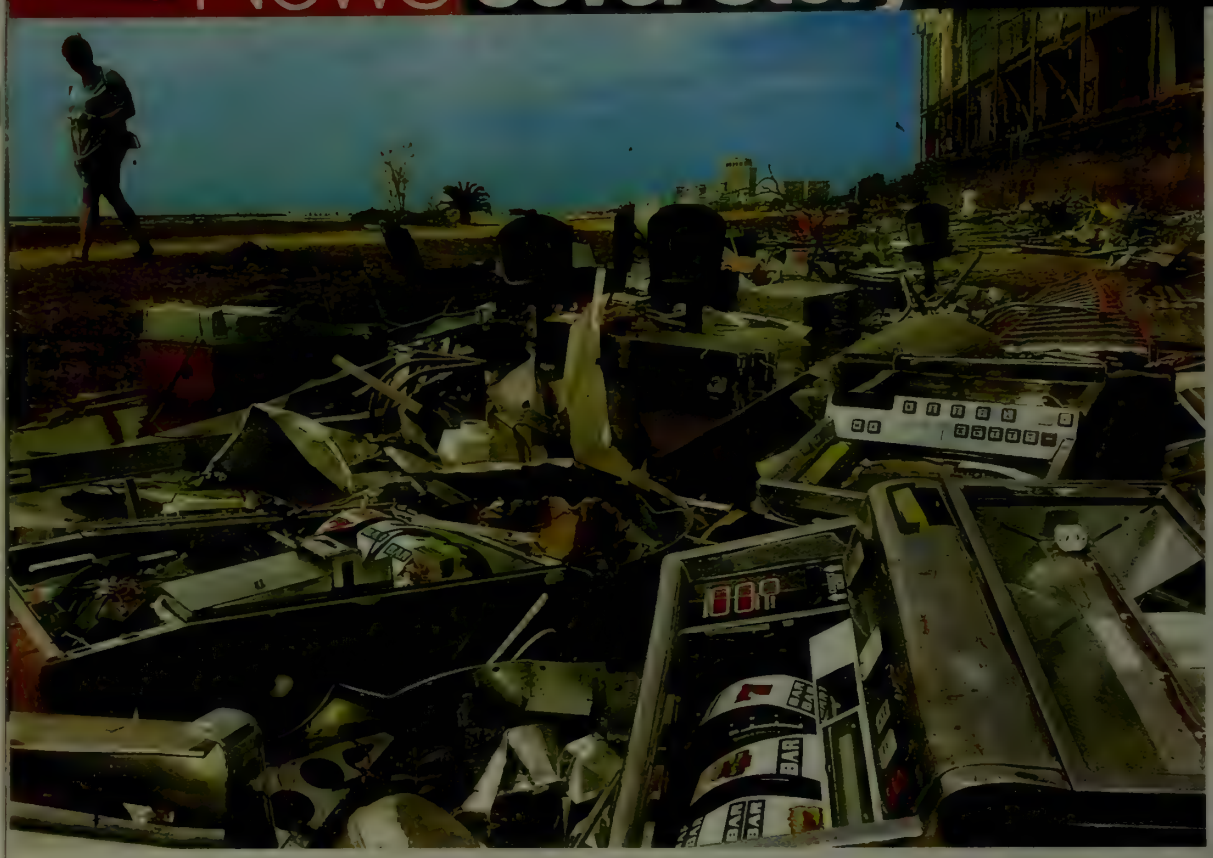

NO JACKPOT Slot machine from the Grand Casino litter the beach in East Biloxi, Miss.

tended period. The result would be a huge drag on the economy, clobbering corporate profits well beyond the energy-intensive sectors such as airlines. Consumer spending, too, could take a dive. While consumers have shrugged off retail prices averaging around $2.60 a gallon nationwide before the storm, if prices stay above $3 a gallon for a long time—or move even higher—that could change. "I think $3 a gallon is a psychologically important threshold for consumers and could finally impact spending," says Mark Vitner, senior economist at Wachovia Corp. in Charlotte, N.C.

But if the situation really gets bad, price won't be the problem. The biggest danger is outright shortages that mean products aren't available at any price. That could keep people from getting the gasoline they need to get to work and could even result in temporary factory shutdowns. Even if those worst-case scenarios don't come to pass, many sectors of the economy could still take a hit. Energy-futures markets are betting that high prices are here to stay. And with many companies already finding it tough to pass price increases through to consumers, economists believe business may simply have to absorb any spike in oil prices. Vitner predicts that corporate profit growth could slow to 8% next year—and to only 4% for those companies not in the energy sector.

Virtually all U.S. wheat, corn, and soy for export goes through New Orleans

SHIPPING BLUES

AIR CARRIERS WILL BE especially hard hit. "The hurricane aftereffect is just one more thing that will make it harder for Delta (page 78) to avoid a bankruptcy filing," says Ray Neidl, an analyst at Calyon Securities (USA) Inc. Delta Air Lines has refused to comment. "Today's jet-fuel prices are crushing and could prove to be a knockout blow for some," says John Heimlich, vice-president and chief economist at the Air Transport Assn., which represents major carriers.

Companies that ship goods through New Orleans and nearby ports also face problems if power and communications are not restored to the area soon. In other times, producers could simply shift traffic through Houston or any other port. But with virtually every other U.S. port running near capacity, there are few easy alternatives. John A. McFarland, CEO of Baldor Electric Co. in Fort Smith, Ark., says his company imports components and exports finished products through New Orleans. "We ship [the components] on a just-in-time basis, but they may be under 20 feet of water," says McFarland. "There's no way to tell when we'll know their condition, or if we can ship from there again."

Still, many believe shipping problems will be relatively short-lived. Says Jeffrey H. Schwartz, CEO of ProLogis, an Aurora (Colo.) provider of distribution facilities and services to the likes of Wal-Mart Stores, Unilever, and DHL Worldwide: "I don't think you're going to see a major disruption in the overall system."

Katrina could also have a damaging impact on the Corn Belt, which stretches from Ohio to Nebraska. Virtually all the export corn and soybeans, and much of the export wheat, is shipped down the Mississippi by barge to terminals in Louisiana. So any backup of barges or damage to terminals could hurt both farmers and grain processors, says Mark Drabenstott, chief regional economist at Kansas City Federal Reserve Bank.

The pressure is on to reopen the ports with the harvest about to start. "The big question is, are we going to be able to move the fall harvest?" Drabenstott says. "To the extent that this backs up the transportation system, that is a question on the mind of the grain trade throughout the region."

Another question is how aggressively the federal government will act to cushion the economic blow. President Bush, already suffering in the polls, partly as a result of high energy costs, has raced to mitigate the economic damage. The White House confirmed on Aug. 31 that it will release oil from the Strategic Petroleum Reserve—a boon to the few refineries

More About Katrina's Wake

Swamped Communications: As repair crews move in, planners ponder how to strengthen the telecommunications infrastructure against future crises.

Impact Scenarios: Here's a look at typical megastorm aftereffects. This one, however, may not be typical

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that are in operating order but haven't been able to get crude because of the shutdown of Gulf output (box).

Financial markets are keeping a close watch on the reactions of the Federal Reserve. The Fed has been steadily raising interest rates to quell inflation. Higher energy prices would ordinarily give the Fed even more reason to jack up rates. But they also weaken growth—which would argue against more rate hikes.

As recently as July, most Fed watchers were betting that Greenspan & Co. would raise short-term rates at least a percentage point more, taking the federal funds rate to 4.5% or higher, yet Morgan Stanley chief economist Richard B. Berner predicts that they may stop when it reaches 4%. In a speech on Aug. 31, Federal Reserve Bank of Philadelphia President Anthony M. Santomero gave few signs that the Fed would pause in its campaign to push rates higher.

Echoing Santomero, most economists believe the U.S. economy is resilien enough to avoid the worst and kee growing at a reasonable clip in spite c Hurricane Katrina's havoc. But for driv ers, truckers, airlines—and the haples Gulf Coast residents caught in its path— this killer storm will cause misery fo months to come. ■

–With Lorraine Woellert i Washington, Christopher Palme in Los Angeles, Stanley Ree in London, and bureau repor

OIL MARKETS

You Can't Feed the Oil Monster With a Dixie Cup

Hurricane Katrina did what months of political heat couldn't: It breached the Bush Administration's stone wall against responding to soaring gasoline prices. On Aug. 31, with 91% of the Gulf region's oil production shut down and nine major refineries knocked out by floods and power failures, the Energy Dept. announced it would let refiners draw crude from the Strategic Petroleum Reserve, while the Environmental Protection Agency temporarily eased clean-air rules for fuel. Critics had been urging similar steps ever since pump prices passed $2 a gallon.

Now gas stations are putting the never-before-seen 3s up on their signs—and the White House moves won't bring them down anytime soon. At best, the few million barrels of crude likely to flow from the SPR will replace missing supplies to keep a few refineries going. Of course, that's better than nothing. "For those refineries that are operating, it's the difference between running and shutting down," says Red Cavaney, president of the American Petroleum Institute.

But the real problem is the refineries that aren't operating. As of Aug. 31 up to 1.8 million barrels a day of refining capacity were offline, taking as much as 45 million gallons of gasoline a day out of a national fuel system that was pumping as hard as it could before Katrina. Until those refineries are running again, all the extra crude in the world can't be turned into gas. Tapping the SPR "is good policy, but it doesn't fix the fact that we have very low gasoline inventories—and they're likely to get much lower because

CHICAGO Is panic buying ahead?

we're not producing," says David Pursell, a partner in Houston research firm Pickering Energy Partners Inc.

Any further disruptions could spike prices higher. Even a small increase in fuel hoarding by price-shocked consumers could make things [illegible] worse, should scattered reports of gas lines create a panic. Political leaders face a dilemma: Encouraging drivers not to top off their tanks [illegible] fears of shortages—and spur [illegible]

The SPR—some 700 million barrels of crude stored in four salt caverns in Texas and Louisiana—was a political football long before gasoline prices started their unrelenting climb. After September 11, President George W. Bush ordered a 159 million-barrel campaign to fill the depleted reserve. As oil prices passed $40, $50, and then $60 a barrel, critics blasted that plan and called on the White House to draw down the SPR. Bush aides insisted the reserve was meant solely for emergencies—and that the SPR's crude couldn't dent the global market.

The government did lend some 5.4 million barrels to refiners after 2004's Hurricane Ivan—a clear precedent for the current deals. *Platts Oilgram News*, a newsletter published, like *BusinessWeek*, by The McGraw-Hill Companies, reported on Aug. 31 that seven refineries had lined up with initial requests for at least 1.5 million barrels. If the deals follow last year's template, refiners will repay oil loans within six months with up to 5% "interest" in the form of added crude.

Some analysts argue that the SPR draws will dampen speculative pressure. Crude prices backed off slightly from their near-$70 level after the release was announced. With the SPR "in play," traders "have to wonder how large the release will be," says Amy Myers Jaffe, an energy expert at Rice University's James A. Baker III Institute for Public Policy in Houston. "It puts a psychological lid on the market." Similarly, the EPA's easing of clean-air rules will let refineries squeeze more gallons of gas from a barrel of oil and ship gasoline tailored for one region's pollution limits into other areas.

But these steps, however welcome, aren't likely to calm a supply chain where players at every level—refiners, wholesalers, retailers, and consumers—fear a supply squeeze and price hikes. For now, price parity between a gallon of premium fuel and a cup of premium coffee is likely to remain a hard fact of life.

–By Mike McNamee and Lorraine Woellert in Washington

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PUBLIC POLICY

LET THAT BE A WARNING

What Katrina can teach about handling natural disasters and energy better

IT IS A NATURAL DISASTER OF UNprecedented proportions for America. But the irony and the tragedy of the killer storm called Katrina is that the hurricane's devastating effects were entirely predictable—and largely preventable. Engineers have known for years that New Orleans levees couldn't withstand anything above a Category 3 hurricane. Ecologists had long warned that the loss of protective barrier islands and coastal wetlands made everything along the Gulf Coast, from refineries to vacation homes, far more vulnerable to major storms. Scientists have been learning that, for whatever reasons, hurricanes have become more destructive over the past 30 years. And with the world's oil-producing and gasoline-refining capabilities strained, it has been clear that storm-related damage to the highly concentrated Gulf Coast energy industry could be hugely disruptive to the nation's oil, gasoline, and natural gas supplies.

Yet not only have these warnings gone largely unheeded but for years government policies have been putting the country at a greater risk of both natural disasters and energy shocks. Along the Gulf, "we've had a tremendously irresponsible policy, destroying protective natural features while encouraging risky and precarious development," says Frederick Krimgold, director of Virginia Tech's disaster risk reduction program. And although Congress passed an energy bill in August, it does almost nothing to solve the problems exposed by Katrina.

The major lesson policymakers should draw from the catastrophe is just how vulnerable the U.S. is becoming to natural disasters and energy disruptions. In fact, some experts say, Americans have been mistakenly lulled into thinking terrorism is the most pressing threat—and they argue that the relentless focus on staving off suicide bombers has left crucial gaps elsewhere. Case in point: After the huge 1993 Mississippi River flood, the Federal Emergency Management Agency (FEMA) began buying up floodplain property, preventing people from rebuilding and being swept away again. But that effort, and a larger FEMA mitigation program, no longer exists. And just this summer, the proposed funding for the New Orleans Army Corps of Engineers district was cut by $71 million for fiscal 2006. Shelved, among other items, was a study to determine ways to protect the region from a Category 5 hurricane.

> **"We've had a tremendously irresponsible policy, destroying protective natural features while encouraging risky and precarious development"**
>
> *—Frederick Krimgold, director of Virginia Tech's disaster risk reduction program*

Americans are already paying the price for these policy lapses in the form of higher energy costs. And inevitably, natural disasters will hit other parts of the nation, in part just because of more development.

PAUL J. RICHARDS/AFP/GETTY IMAGES

THE I-90 BRIDGE Ecologists warned for years that too much building could end in chaos

New York and Washington certainly aren't immune, warns John N. McHenry, chief scientist at Baron Advanced Meteorological Systems, a forecasting outfit in Raleigh, N.C. Says McHenry: "It would not take much to flood all of Manhattan."

Everyone with an agenda is pushing his pet ideas as a solution. House Energy & Commerce Committee Chairman Joe Barton (R-Tex.) thinks that our energy woes can be solved with more production. "We could be drilling in Alaska right now," he says. On the other side of the political spectrum, activist Robert F. Kennedy Jr. blames the Bush Administration for failing to push tough fuel economy standards and curbs on global warming. Says Kennedy: "Katrina is giving our nation a glimpse of the climate chaos we are bequeathing our children."

Partisan fulminations aside, there are policy lessons from Katrina on both the energy and the natural resource management fronts. Here's what could be done:

» Restore natural buffer zones.

The combination of the Mississippi River levees and oil and gas development has had a devastating effect on the whole Gulf Coast. The levees prevent sediment from reaching the delta. Meanwhile, oil and gas companies have dug channels through the wetlands and sucked oil from underneath, causing the land to sink, saltwater to intrude—and thousands of acres to submerge. Although reclamation measures were already under way to restore Gulf marshlands, they were too little too late. "I'm hoping that one lesson to come out of this is that talk about rolling back protections for wetlands [all across the country] will end," says Yale University ecologist David K. Skelly.

» Limit development in the most vulnerable areas.

Experts say it's crazy to keep building casinos and vacation homes on coastal dunes, barrier islands, and other vulnerable spots. One solution is to stop offering federal insurance for such projects. Another is to put the land off limits to development. During the Clinton Administration, FEMA "was working hard" to slow such development, says Virginia Tech's Krimgold. But such efforts ended after FEMA became part of the Homeland Security Dept.

Aiming for a better balance of risk and development means tough decisions. A city like New Orleans, lying in a vast bowl below sea level and protected by fragile levees in a hurricane belt, probably should never have been built. But once it was there, more effort should have been put into strengthening the levees and the city's pumping system. "We knew this was a danger, and it was clearly brought to our attention," says Senator Jim DeMint (R-S.C.), who is working on a bill to improve emergency communications during disasters.

» Get serious about climate change.

"It is increasingly clear that global warming makes [hurricanes] more severe and destructive," asserts former Energy Dept. official Joseph Romm. "Katrina is the shape of things to come." Plus, action to combat climate change, such as increased development of renewable sources, has the additional beneficial effect of reducing the nation's vulnerability to energy shocks.

» Make a Presidential appeal.

In the short term, experts suggest, President Bush could minimize the impact on gasoline prices simply by asking Americans to be more aware and careful—by inflating tires, tuning up cars, and driving more slowly. The Environmental Protection Agency also relaxed clean fuel standards to reduce the number of gasoline formulations refineries need to make and to open the door to more imports. Over the medium term, moving to a single national standard for gasoline would reduce pressure on stressed refineries.

» Increase energy diversity.

Over the longer term, the answer is greater diversity—of sources, geographic locations, types of energy—and greater use of energy-efficiency measures. Combined, these steps would make the economy more immune to energy shocks. A number of states, for instance, have already required that a certain percentage of electricity be generated from renewable sources. A national standard would help even more to reduce the impact of shortages or price spikes in natural gas.

» Boost energy efficiency.

Improving the fuel economy of the cars and trucks Americans drive to 40 mpg would save 6 million barrels of oil a day, many times more than is being lost because of Katrina.

Indeed, all these policies are simple, if not easy, and most have been suggested for years. In the end, Katrina could be a wake-up call for pols to finally stop posturing and get serious about the nation's energy vulnerabilities. If they don't, cataclysms like Katrina could happen again. ■

–By John Carey with Lorraine Woellert and Eamon Javers in Washington, with Otis Port in New York

CANAL STREET Many locals may not want to come back

NEW ORLEANS

THE BIG EASY'S BIGGEST CHALLENGES

Preventing future floods will take a Herculean effort. So will reviving tourism

NEW ORLEANS WAS their destination, until it was submerged. The 17 cousins, uncles, and friends from across the country had planned a three-day trip in October to the Big Easy, capped off by a National Football League game at the Louisiana Superdome. They rented $150 hotel rooms and shelled out $45 a ticket for the game. Hundreds more would be spent partying in the French Quarter. But after Hurricane Katrina sank their plans, they canceled the trip on Aug. 30. Instead, they'll spend those dollars in Tampa Bay. "We don't feel with all the damage that they'll even be able to open the city," says Michael A. Merbach, one of the planners.

Will New Orleans ever reopen? Hurricane Katrina smashed homes, halted business, closed the port, and crushed the city's tourist trade. Last year visitors spent $4.9 billion cavorting there—44% of the state's tourism take. Now, with 80% of the city under water, those revenues could evaporate, along with $158 million in state tax revenues. Trade, which employs 95,000 in the city, could be stymied for months. About 30% of the $25 billion in insured losses occurred in New Orleans proper, say insurance analysts.

Bringing tourists—and residents—back to New Orleans could prove tough. The tourist business, which employs 84,300 people, is petering out fast. Airlines have been forced to cancel flights, and hotels have halted bookings. Officials at Omni Hotels in Irving, Tex., which owns two New Orleans properties, canceled all reservations through Sept. 24. Worse, the convention business has been upended. The AARP was due to hold its annual meeting there in late September. Registration had hit 25,000. "The question was: Would New Orleans be a bigger draw than Las Vegas last year?" says the AARP's Nancy Thompson. "Now we'll never know."

Another danger is that locals who go away won't come back. Glenn Gardner, 35, grew up in New Orleans but moved away after college. Now his parents are holed up at his house in Marietta, Ga. Friends with businesses back home, he says, fear what kind of mess they'll return to. His parents have nowhere to make a fresh start and will return. "Young people are asking, 'Why should I move back?'" says Gardner.

"BOWL OF FUTILITY"

SOME LAMENT THAT New Orleans did not take better care of itself. The state loses about 17 coastal miles each year as erosion and overbuilding smooth out shoreline curves. With a poverty rate of 23.2%, New Orleans is one of America's poorest cities, with a median annual income of $31,369, just 70% of the national average. Much of the damage from Katrina fell on the poor. "It's insane to flush more money into this bowl of futility," wrote an anonymous blogger at buzzmachine.com on Aug. 31.

It's not as if New Orleans hasn't tried. It spent billions to shore up its 2,000 miles of levees, sea walls, and pumping systems. A $14 billion, 30-year program in the 1990s, dubbed "Coast 2050," aimed to refill marshes and shore up coastal islands to provide more barriers against storms. But it languished because of the high cost. Now engineers say it could take three to six months just to figure out the scope of Katrina's damage. Beyond insurance payouts, rebuilding is expected to run into the billions.

For centuries the Netherlands, a sinking country on the edge of a rising sea, has coped with such woes. The constant threat of floods has seeped into the national psyche. A corps of civil servants maintains the dikes, barriers, and pumping stations that keep the nation dry. The centerpiece: massive barriers that protect the coast from rising tides when the North Sea grows stormy. Katrina may well be motivation enough for New Orleans, with the help of the rest of the country, to build up similar, if costly, defenses. ■

–By Brian Grow in Atlanta, with Timothy J. Mullaney and Adam Aston in New York

THE STAT

14

Percentage of New Orleans jobs that were in tourism, compared with 9.6% for the U.S. as a whole

Data: Bureau of Labor Statistics

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Lipper Multi-Cap Value Funds Average	10.72%	6.22%	10.14%	1.59%
Dividend Growth Fund	**7.85%**	**3.20%**	**9.74%**	**0.78%**
Lipper Multi-Cap Core Funds Average	7.16%	-0.36%	9.37%	1.48%
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ACCOUNTING

INSIDE THE KPMG MESS

Why eight partners may be facing jail time—and what the suit could mean for the tax-shelter business

ON AUG. 26, THE JUSTICE DEPT. won a landmark tax-shelter case when accounting giant KPMG admitted to criminal tax fraud and agreed to pay $456 million in penalties. The government will defer prosecution and drop the case after Dec. 31, 2006, if KPMG stays out of the shelter business and cooperates with prosecutors in related cases. It could have been a lot worse for KPMG—think back to Arthur Andersen's fate. But for the eight former KPMG partners and an outside lawyer whom the government has indicted, the price may be high indeed. What's more, the case is sure to send shock waves through the accounting and legal professions, where individuals are now on notice that they are no longer immune to government prosecution. Here's a look at what the charges are all about, how they may play out, and the wider implications of the case:

What does the Justice Dept. claim KPMG and its partners did?

The government alleges KPMG and its partners committed tax-shelter fraud by selling illicit deals and then misleading the Internal Revenue Service about the transactions it orchestrated for wealthy individuals between 1996 and 2003.

The shelters were called BLIPS, FLIP, OPIS, and SOS. All were allegedly designed to create phony losses that investors could use to reduce their taxes. For example, BLIPS—"Bond Linked Issue Premium Structures"—were sold to at least 186 wealthy individuals and generated at least $5 billion in tax losses. A client would borrow from an offshore bank to buy foreign currency from the same bank. Roughly two months later the client would sell the currency back to the lender, creating what the government contends was a phony tax loss that the client could then deduct from his capital gains and income from other investments. SOS was a similar but more complex currency deal; FLIP and OPIS involved investment swaps through the Cayman Islands, a well-known tax haven. The IRS contends that all these loans and investments were risk-free, sham transactions designed solely to reduce taxes—to the tune of nearly $12 billion in phony losses that cost the Treasury $2.5 billion.

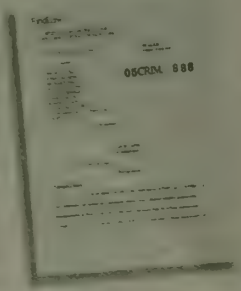
Are the deals illegal?

The IRS says so, but the courts have not yet ruled on the matter. The IRS has a mixed record in shuttering such transactions. Under what is known as the economic-substance test, the IRS has claimed that shelter deals done solely to reduce taxes are improper. But federal courts have sometimes ruled that such transactions are O.K., even if they carry no economic risk or opportunity for reward beyond their tax savings.

Does that mean the KPMG partners and the outside lawyer may get off?

Possibly, but they face a tough battle. Lawyers for the individuals charged deny the allegations and are likely to cite the deals' uncertain legal status in their client's defense. But "the government has a very strong case," says Sheldon D. Pollack, director of legal studies at the University of Delaware. "A lot of the transactions were so aggressive that there's no basis for claiming they're legitimate."

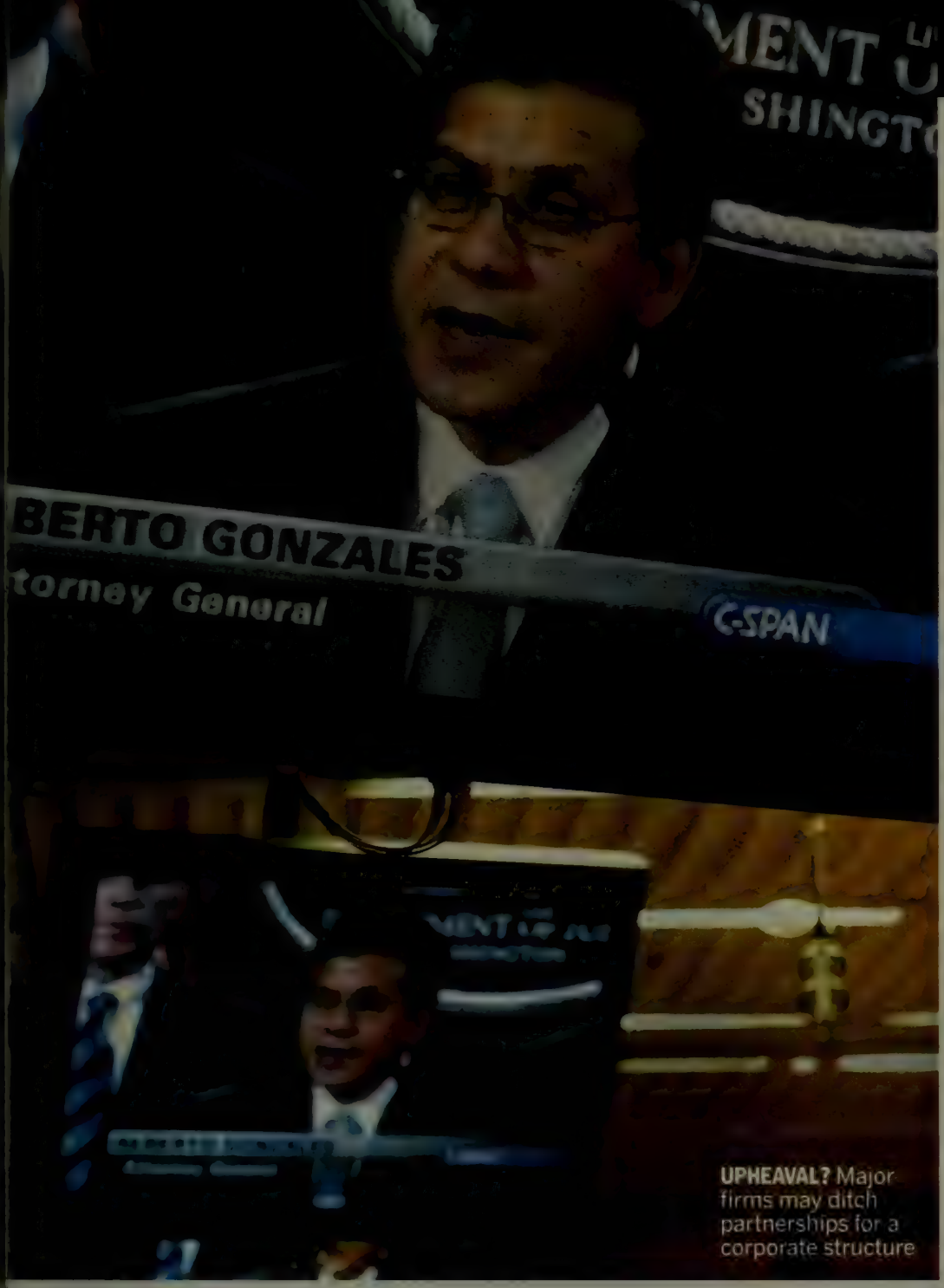
Still, Justice worries that it may not be able to convince a jury that these immensely complex deals were illicit. So the indictment goes beyond the question of whether the deals themselves were proper. It alleges that KPMG, its eight former partners, and the outside lawyer conspired to mislead the IRS by lying about the details of the shelters. For instance, on BLIPS, the defendants allegedly presented the currency purchases as seven-year investments—even when they knew most clients cashed out after 67 days. The deal's documents also said KPMG, its law firm, and other parties operated independently, while Justice charges that they worked together to package the shelter.



The government alleges that eight former KPMG partners and an outside lawyer "...participated in a scheme to defraud the IRS by devising, marketing, and implementing fraudulent tax shelters"

How will these charges affect the tax-shelter business?

Major accounting and law firms have sharply curtailed their marketing of tax shelters, at least for now. One big worry: lawsuits brought by angry clients forced to pay back taxes and penalties. KPMG will argue that its clients were savvy investors who knew



UPHEAVAL? Major firms may ditch partnerships for a corporate structure

ey were taking risks to reduce their taxes. ıt the firm's admission of guilt will overhelm that argument, says Stanford Unirsity law professor Joseph Bankman:)nce the firm admits wrongdoing, it's a on to a private party that bought the shelrs and wants to sue the firm."

Now, most shelters are being peddled tax "boutiques" operating on a much naller scale. Those firms can fly under e IRS's radar more easily than can the g Four accountants or national law ms. But if the government wins convicons against the KPMG partners, even ese firms may become wary about how ey market their deals.

n't Congress simply outlaw shelters?

ost abusive shelters are based on legal x-planning techniques—but carried to extremes. That makes it hard to draw sharp lines between legitimate tax planning and illicit shelters. The Senate Finance Committee has been pushing for years to enact into law the criteria that the IRS uses internally: If a transaction has no economic purpose beyond simply reducing taxes, it would be illegal. So far the White House and the House have blocked that change, but Finance Committee Chairman Chuck Grassley (R-Iowa) is likely to keep trying. The case should give him new ammunition.

Does the government usually bring criminal charges against partners?

No, at least not in the past. In his 30-plus-year career, University of Georgia accounting professor Dennis R. Beresford says he has seen only one partner at a major firm sent to jail for professional misbehavior. That changed with Enron: Since 2002 the government has indicted more than 20 tax lawyers, and many more may be in the Feds' sights.

In this case, Justice feared an indictment of KPMG would put the firm out of business, leaving only three international firms to audit large corporations. But prosecutors were under tremendous pressure to punish shelter promoters—so they targeted the individual partners.

How will the KPMG case change the accounting profession?

What's striking, industry experts say, is how KPMG has thrown its former partners overboard while giving the government evidence to use against them. The case "sends a very solid message to any partner: Even if what you're doing has the firm's blessing, if the firm gets in big trouble, you're going to be on your own," says Jonathan Hamilton, editor of *Public Accounting Report*, a Las Vegas newsletter.

The $456 million fine could cost every one of KPMG's partners as much as $300,000. They will also bear the cost of civil damages awarded to former clients. That open-ended liability, without the promise that the firm will stand behind them, may cause the profession to shift from long-standing partnerships to a corporate structure.

Will these charges force tax professionals to clean up their act?

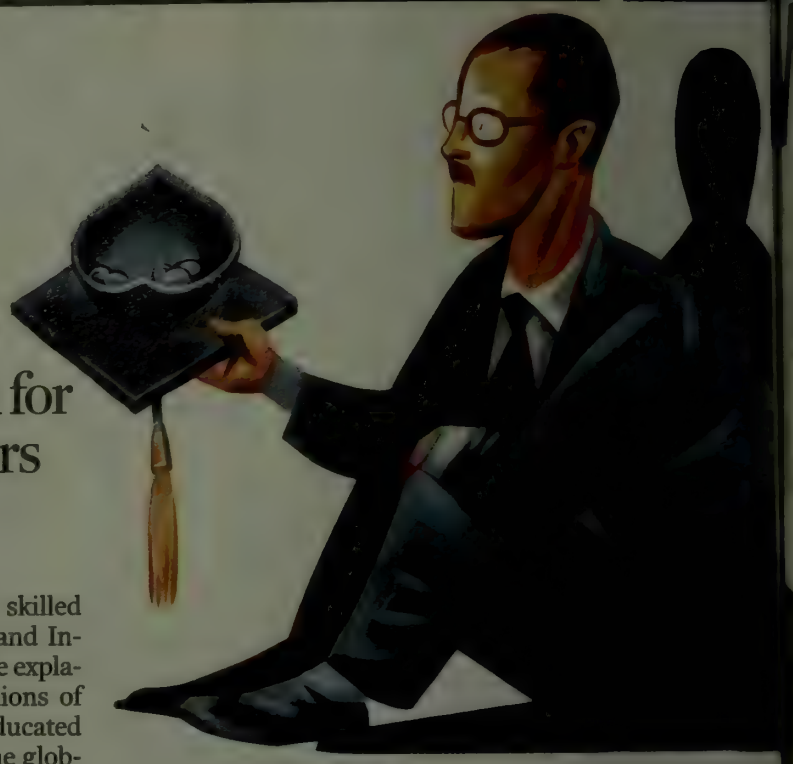
Nothing concentrates the mind of a wayward professional—or one who's contemplating actions that cross an ethical line—like the threat of jail time. "There must be partners in other firms thinking: 'There but for the grace of God go I,'" says Paul R. Brown, an accounting professor at New York University's Stern School of Business. The truly sleazy shelter peddlers, who can pack up their boiler rooms and flee when the G-men come knocking, may not be deterred. But partners at major law and accounting firms will think twice about pushing too hard for tax-shelter millions. ■

–By Howard Gleckman and Amy Borrus, with Mike McNamee, in Washington

THE ECONOMY

COLLEGE: THE PAYOFF SHRINKS

Grads' real earnings have fallen for four years. Here's why it matters



SOMETIMES WHAT'S BEneath the surface is more important than what's on top. When the U.S. Census Bureau released the income and poverty numbers for 2004 on Aug. 30, it didn't seem like much had changed. Real income edged down a bit for the second straight year, and the poverty rate got a bit higher.

But after some digging and a few twirls of a spreadsheet, the data in the report verifies what many have feared: The Americans who should be prospering in a knowledge economy—the college-educated—are instead taking it on the chin. Real earnings for workers with only a bachelor's degree have fallen for four straight years, for the first time since the 1970s. And the decline—about 5% since 2000—shows no signs of abating.

This is a big deal, economically and politically. For two decades, from 1980 to 2000, pay for college-educated workers marched relentlessly upwards, leaving workers with a mere high school diploma in the dust. Economists wrangled for years about whether this growing "college wage premium," as it was called, was due to technology, or globalization, or something else. But whatever the cause, few questioned that a college education is the route to a good life.

Since 2000, however, the college wage premium has shrunk, because the pay of high school graduates has eroded less than that of college grads. Why? Outsourcing of skilled jobs to China and India is part of the explanation, as millions of their college-educated workers join the global economy. Wages may also be held down by oversupply in the U.S., since the number of college-trained workers here has grown by 32% over the past 10 years, compared with only an 8% rise for all other education levels. Technology may be getting simpler and easier, requiring less education to use. Or the drop in grads' earnings may be a temporary hangover from the tech bust.

So far college-educated workers have given back only a small part of their previous gains. Since 1994 earnings for Americans with a bachelor's degree are up about 10%.

Still, unless the trend of the past four years reverses, the clear benefit of attending college will become tarnished. That could make it a lot harder to persuade students and parents to ante up big bucks for tuition and room and board. Moreover, if the college premium continues to shrink, fewer young people will want to sacrifice to get a degree.

The declining earnings of the college-educated could also change the political landscape. Exit polls after the 2004 Presidential elections suggest that voters with only a college degree went 52% to 46% for George W. Bush over John Kerry. That's a big reason why Bush won—but the college-educated could be ready for a change by the next election.

"I Need a Raise!"

EDUCATION LEVEL	CHANGE IN REAL EARNINGS 2000-04*
High school diploma	-0.2%
Some college, no degree	-4.3
Associate degree	-2.5
Bachelor's degree only	-4.9
Advanced degree	2.5

*[illegible] 25-64
Data: [illegible] Bureau of Labor Statistics, BusinessWeek

Still, it isn't easy for the Democrat Party to adopt policy proposals aimed a helping this group while addressing th concerns of their traditional lower-in come constituents. Most safety net pro grams would not help the college-educa ed, who make far too much to quali even with earnings falling. "It's hard t say they're going to turn to old FDR-sty activist government," says Stephen Ros a well-respected labor economist an consultant who recently analyzed whic income and occupation groups directl benefit from Democratic programs.

TOUGH CALL

ANOTHER COMPLICATION for the De mocrats is their repeated attacks on th budget deficit run up by the Bush Admin istration. Unfortunately, cutting th deficit would probably involve raising tax es on the top 20% of households, includ ing many with just a college degree.

The best response, for either the De mocrats or the Republicans, may be to ig nore the deficit and sharply beef u spending on education and research That would have the economic advantag of investing for long-term growth an competitiveness. And it would have th political advantage of creating jobs a home for college-educated workers wh fill teaching and research positions. Doin well by doing good may be the name o the game. ■

–By Michael J. Mandel in New Yor

BusinessWeek online Want to discuss falling college wages? Go to Mandel's blog at businessweek.com/the_thread/economicsunbounc

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PHARMACEUTICALS

A BETTER WAY TO AMBUSH AIDS?

Panacos Pharmaceuticals' experimental drug opens the door to a new line of attack

IN THE U.S., AIDS MAY NOT SEEM to be the urgent problem it once was. Powerful drugs introduced since 1996 have slashed the annual death rate in the U.S. from nearly 50,000 in 1995 to 16,000 in 2004. But the picture is still grim. New cases of infection continue unabated, at about 44,000 per year, with more Americans than ever—more than 1 million—infected with HIV. Around the world the epidemic is growing, with more than 40 million people carrying the virus. What's more, HIV increasingly outwits today's drugs even as side effects take a toll.

That's why an urgent need for new treatments remains—especially those that tackle the virus in new ways. Now an experimental drug is showing promise. In late September researchers from Panacos Pharmaceuticals Inc. in Watertown, Mass., are scheduled to present results of a clinical trial showing that their drug, dubbed PA-457, can dramatically reduce levels of the virus. "This is quite exciting because of the novel mechanism of action," says Dr. Daniel R. Kuritzkes, director of AIDS research at Brigham & Women's Hospital and professor at Harvard Medical School.

There is still a long road ahead. While the drug appeared safe and effective in a so-called Phase II trial, it was given to only 33 people for 10 days. Proving that PA-457 can be taken safely for years "is the next hurdle," says Carl T. Wild, Panacos' chief science officer. Even if all goes well, doing a larger Phase III trial and getting Food & Drug Administration approval will take several more years. But so far there are no signs of trouble. "There are a series of 'ifs,' but if it pans out, this could be substantial," says Needham & Co. analyst Clay Wilson. Needham predicts th the drug gets approved, sales could ily top $500 million per year.

WILD Proving long-term safety "is the next hurdle"

"MATURATION INHIBITOR"

EVEN IF PA-457 STUMBLES, it open door to a new attack on HIV. All but of the 28 approved drugs fight the in one of two ways. After HIV gets i cell, it hijacks the cell's machiner copy itself. One class of drugs, calle verse transcriptase inhibitors, block enzyme the virus uses to do this. second type of drug, the protease hibitors, act later. An HIV gene ca gag contains instructions to make a protein that becomes part of the viruses. For the viruses to become in tious, this protein must be cut into eral pieces. Protease inhibitors block enzyme that cuts the protein.

Panacos' experimental medicine fers a new tack. The original compou found in a variety tree barks, was disc ered nearly 10 y ago by Kuo-Hsu Lee at the Universit North Carolina as p of an effort to thousands of nat substances for a HIV or anti-cancer fects. Then it tweaked to make more potent. In 2 scientists at Panac with the help of Dr. Eric Freed at the N tional Cancer Institute, figured out hov works: It prevents the gag protein fr being cut in one key spot. New virus still get released from infected cells, b they're harmless. "The drug hits t same step as the protease inhibitors, b by a quite different mechanism," sa Freed. Because it bollixes up the last st called maturation, in the virus' life cyc it's called a "maturation inhibitor."

The drug's precursor was found in the bark of trees

Since it works in this new way, Pan cos' drug is effective against HIV strai that have acquired resistance to protea inhibitors, a growing problem in AI treatment. In the test tube, using PA-4 and a protease inhibitor together is f more effective than either drug alon The next step: testing PA-457 in comb nation with other antivirals. "It's too ea ly to say if this will be the next wid spread drug, but everything looks abo as good as it could at this point," sa Freed. The AIDS battle is still ragin Now doctors may get a new weapon f their arsenal. ■

–By John Carey in Washingto

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EDITED BY ANNE NEWMAN

HEADLINER

O.V. DELLE-FEMINE

MECHANICAL FAILURE

In the four decades since he founded the mechanics union now on strike at Northwest Airlines, O.V. Delle-Femine has built the union's membership on a core principle: Make no wage concessions. For years that hard-line position worked, allowing the Aircraft Mechanics Fraternal Assn. to raid existing unions at other airlines to swell its ranks.

Now, with the Aug. 20 walkout showing virtually no sign of success, the strike seems likely to spell the end of labor militancy in the troubled airline industry—and dramatically weaken AMFA itself. Delle-Femine, 72, clearly underestimated Northwest's ability to hire replacements for the union's 4,300 mechanics. The narrow group of workers he represents also gave him little leverage in hurting the Eagan (Minn.)-based carrier.

Labor experts say the strike's failure will undermine confidence in Delle-Femine's leadership among the other 12,000 members at seven other airlines. But the mechanics union's Northwest workers will be first to pay the price. *–Robert Berner*

A MASTERCARD MASTER PLAN

MasterCard International is taking a big swipe at rivals **American Express** and **Visa International**. The Purchase (N.Y.) company said on Aug. 31 that it plans to go public in early 2006. With at least $650 million in proceeds it plans to retain from the IPO, MasterCard hopes to gain an edge in the brutal credit-card market. Current investors, about 1,400 banks and financial institutions, will own 41% through nonvoting shares. Public stockholders would own about 49% in Class A shares; a new MasterCard charitable foundation will own the rest. With fees under pressure from consumers and regulators, MasterCard says the fresh capital will also go in part to "defend our interests in the legal and regulatory arena." Second-quarter revenues rose 19%, to $772 million, and profits jumped 82%, to $120 million.

ICAHN: A 10% SOLUTION?

Would financier Carl Icahn and his hedge-fund partners actually pony up $6 billion more to boost their 2.6% stake in **Time Warner** to 10%? It seems unlikely, since the Icahn group and Time Warner CEO Richard Parsons seem to agree on a strategy for the media giant: spin off the cable business and buy back stock. But as reports suggested on Aug. 30, Icahn is clearly not retreating from trying to push Parsons to take larger measures more quickly. Time Warner's shares rose 42¢, to about $18, after news of the 10% threat leaked. Icahn could not be reached for comment.

MUSIC TO APPLE'S EARS

Just one e-mailed invitation on Aug. 29 was enough to get the **Apple Computer** hype machine cranked up. After Apple invited media to a Sept. 7 event, analysts began buzzing about the expected unveiling of a phone, made by **Motorola**, that can play songs stored in Apple's iTunes music software. Analysts say **Cingular Wireless** will offer the phones to its cellular customers. Still, it remains to be seen whether such a product would have the pizzazz that helped Apple dominate the MP3 music player market with its iPod. And speaking of iPods, rival **Creative Labs** said on Aug. 30 that it had won a patent on music player interface design. One option for Creative: to seek royalties from Apple.

MICROSOFT'S NEW CALLING

Microsoft upped the ante in its ongoing battle with **Google** and **Yahoo!** for Internet users, acquiring a small San Francisco startup that has developed technology for handling phone calls made over the Net. Microsoft bought **Teleo** on Aug. 30 for an undisclosed sum, though **Goldman Sachs** analyst Rick Sherlund speculates the small, two-year-old, privately held outfit cost "well below $100 million." The deal gives Microsoft technology that lets customers make calls over t Web to conventional phone as well as Net-connected on Microsoft plans initially to integrate the Teleo technolo into its MSN online service better compete with Google and Yahoo, which are beefi up their instant-messaging services.

ET CETERA...

>> A U.S. District judge dismissed a lawsuit accusin nine drugmakers of colludi to block imports from Cana

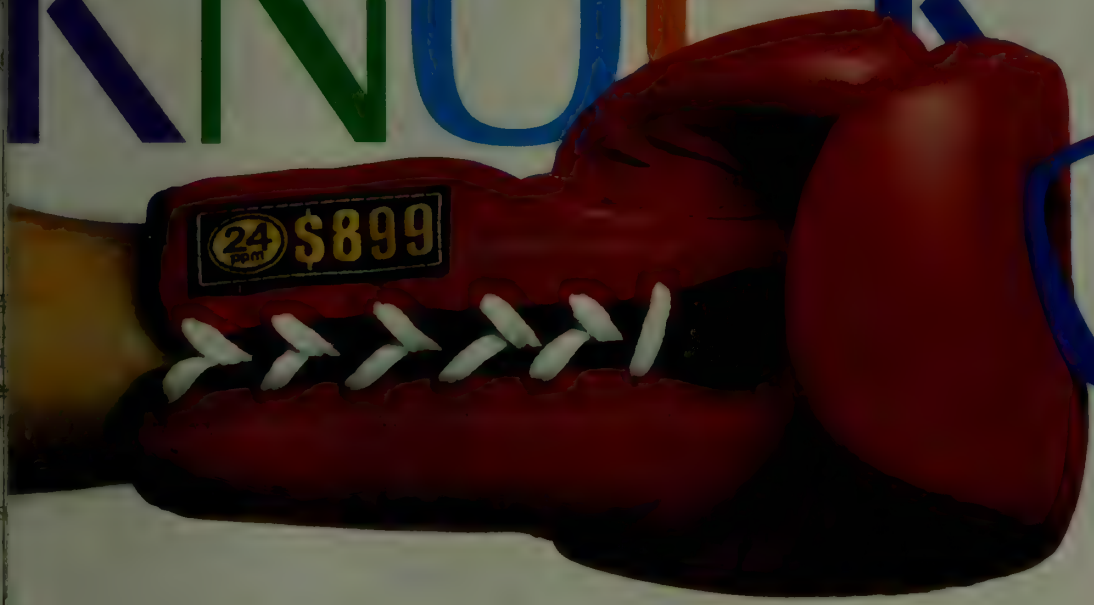
>> **McDonald's** named **Quak Foods** President Mary Dillo as chief global marketing officer.

> **MedImmune** will market it respiratory drug, Synagis, without **Abbott Laboratories**.

CLOSING BELL

Tiffany shares are sparkling. Second-quarter earnings soared 53%, and the luxury retailer raised its full-year profit forecast by 8% as well-heeled consumers snap up pricier baubles and a long-awaited turnaround in Japan kicks in. Shares rose 12.3%, to $37.42, on Aug. 31.

KNOCK OUT



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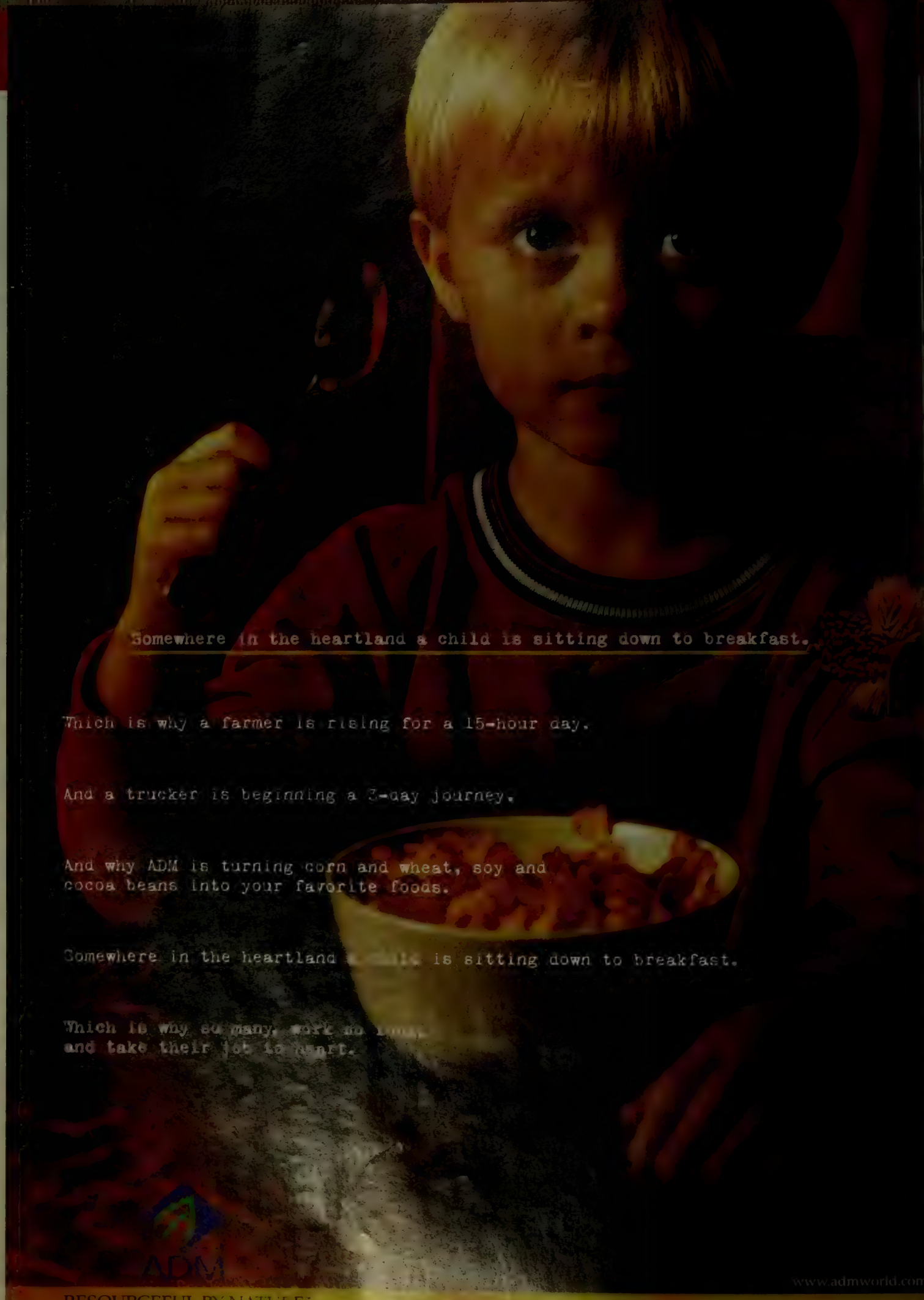
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An ID-Theft Crackdown Gains Momentum

UNT SENATOR TED STEVENS (R-Alaska), a feisty foe of Big Gov-nment, as a new believer in federal action to thwart identity eft. In advance of a Commerce Committee hearing last May on e ever-expanding assault on high-tech privacy, panel staffers d some Internet snooping and surprised Chairman Stevens h a dossier of sensitive data, including offer to sell his Social Security number, unlisted phone numbers, cell phone ling records, and reports on his daugh-'s property rentals. That's info online mmers could use to hijack a person's ntity, a form of e-crime that is growing pervasive that even laissez-faire Repub-ns want tighter controls.

"This is a very serious thing," Stevens s. His committee has already approved islation that directs companies oversee-Americans' personal files to take onger steps to secure them, and a raft of er Hill panels are crafting similar bills. e catalyst: a wave of hacker attacks and st" databases that have osed millions of Ameri-s to potential ripoffs. sing an issue with legs, White House may weigh with a Justice Dept. and deral Trade Commission ke force to crack down on a theft.

Consumer advocates are ping for new legislation yearend, and financial in-stry lobbyists see tighter a controls as inevitable. t business reps are work-hard to block costly mpliance rules or new le-l exposure. "Do we want a l with all the bells and whistles? Proba-not," says one banking lobbyist.

CONVERT Stevens was handed data on himself found on the Internet

rror stories galore

USINESS HAS BEATEN BACK tough new ivacy rules for years. But this time, horror ries about rampant ID theft may have rned the tide. "It's hard for a member of ngress to go home and say, 'We couldn't t this done,'" reckons Evan Hendricks, tor of the Washington-based newsletter *Privacy Times*. "The issue will be whether industry lobbyists can derail this."

Insiders say emerging legislation could include the following elements:

Specific Safeguards. The FTC would be directed to give companies clear standards, akin to those used by bank regulators, on storage and protection of sensitive data.

Consumer Notice. The feds could adopt rules, like California's law, requiring companies to inform customers about data breaches. Banks fear they'll be required to send millions of notices—and alarm customers—about routine glitches.

Credit Freeze. Stevens' bill would let individuals order temporary freezes on their own credit, a move that would block applications for new mortgages and credit cards if consumers suspect their ID has been filched.

Social Security Numbers. The law could limit use of Social Security numbers as primary financial identification. Sale of others' SSNs would largely be banned.

Why would financial outfits go along with such new sanctions? Largely because new federal laws would preempt a patchwork of conflicting curbs that are sprouting in the states. "Our guys are playing whack-a-mole in state legislatures," says a banking lobbyist. "Even if [Congress adopts] a costly standard, it's better for us to have one [law] across the board."

Washington lobbyists say that data protection has so much momentum that new legislation has a good shot at passing. Make that chance about 100% if another lurid tale about pilfered personal files hits the airwaves this fall—or if the victims include Washington lawmakers. ■

–By Eamon Javers

CAPITAL WRAPUP

GREENSPAN TAPS HIS INNER TECHIE

THE GREENSPAN Era really must be ending. After 18 years with a staff of top-flight economists at his beck and call, Federal Reserve Chairman Alan Greenspan is figuring out how to fetch his own data. Fed staffers say the 79-year-old chairman has been peppering them with questions on how to use the Internet and financial news terminals to track the economy. Greenspan, who has long celebrated technology's power to fuel growth, is also using e-mail, which he has avoided like an inflation spike. No word yet on whom he'll call when his computer crashes.

THE BITTER AND THE SWEET

SUGAR FARMERS helped lead the opposition to the Central American Free Trade Agreement, which squeaked through the House in late July after heroic Administration arm-twisting, and Administration officials are in no mood to forgive. Luther Markwart, CEO of the American Sugarbeet Growers Assn. and a vocal CAFTA foe, has been bounced from the Agricultural Policy Advisory Committee for Trade. "No industry group has a safe seat," said an Agriculture Dept. official.

A GARTER-BELT FIGHTER FOR THE FCC

THE FEDERAL Communications Commission has brought anti-smut crusader Penny Nance on board to battle sex and violence on TV. As president of the Kids First Coalition, Nance helped generate nearly 7,000 complaints to the FCC over a 2003 Victoria's Secret lingerie show on CBS—a record response for a single program.

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DIPLOMACY

MR. HU COMES TO WASHINGTON

When he sits down with Bush, the challenges he faces at home will cast a long shadow

CHINESE PRESIDENT HU Jintao heads to Washington on Sept. 7, representing an economically ascendant nation that many in the West think is destined for superpower status. Hu's tightly scripted tour through the U.S. will include plenty of face time with President George W. Bush, the pomp of a 21-gun White House salute, a speech at Yale University, and visits to the U.N. in New York and to Microsoft Corp. headquarters in Redmond, Wash. As he meets with America's political, business, and intellectual elite, Hu will project an image of a rapidly modernizing China that offers huge commercial benefits to the U.S.

The usual goodies will be exchanged. Bush will probably praise Hu's government for its recent moves to liberalize trading in the yuan, and Hu may whip out his checkbook following August announcements that China's state-owned airlines will spend $6.2 billion to buy 52 Boeing 787 planes. And China could also announce a deal to buy nuclear-power technology from Westinghouse Electric Co.

All in all, the expectation is that Hu's visit will be a relatively friendly affair that will paper over a far more complex reality governing Sino-American ties. "China and the U.S. share important common interests in the Asia Pacific region, and we are willing to work together to make the Asia Pacific more peaceful, stable, and prosperous," says a senior Chinese official in Beijing. "The whole world acknowledges that our countries are the two major engines for economic growth."

Yet few in the West fathom the contradictory development challenges China confronts—and how they limit and shape its dealings with the U.S. and others. Yes, it is home to a potentially vast consumer market and abundant and cheap labor, but it has equally vast income inequality, joblessness, environmental wreckage, and a rapidly aging population. Hu is trying to balance high-speed economic growth with social stability, and more transparency in government with authoritarian, single-party political control. China is not only a dynamo whose companies are increasingly assertive in moving abroad—witness the purchase of IBM's PC business by Lenovo Group Ltd.—but also an extremely fragile place. "They have a lot of fingers in a lot of dikes. They're just trying to maintain stability," says a Bush Administration insider.

Just how deftly Hu manages these challenges will shape China's relations with the U.S. and also its long-term prospects of breaking into the rich-country club. Just as the U.S government is full of China skeptics who suspect that Beijing's future role in global affairs will be far from benign, many in the Chinese Communist Party and military think the U.S. will block any Chinese company that tries to acquire U.S. corporate assets and will exaggerate any move by China to improve its defense posture. This bilateral relationship is anything but simple. It's important for the Bush team to understand the constraints China is operating under—as well as what motivates leaders such as Hu. That may make it easier, in the longer run, for the U.S. to get more of what it wants from Beijing.

» Hu is trying to balance rapid growth with social stability. The Chinese have "a lot of fingers in a lot of dikes," says one Bush insider

Who is Hu? Even though he has bee the top leader in Beijing for two-plu years, the 62-year-old President is sti seen as hard to read by many observer "He wears a public face even in private, says Kenneth Lieberthal, a China expe at University of Michigan and a forme Clinton Administration official. "I don know any Chinese who can say with con fidence what he is thinking about." Stil it's possible to draw conclusions from h

CAUTIOUS The President is still consolidating his power

nure so far. Although some analysts in hina and the West hoped he would be a emocratic reformer, Hu is turning out to e a cautious and often conservative agmatist who stresses party discipline. e has cracked down on the media, inuding jailing journalists, is trying to ntrol Internet use, and recently used e *People's Daily*'s front page to threaten rest for citizens holding unauthorized otests. Moreover, Hu isn't as enthusiastic about things American as his predecessor, Jiang Zemin.

The backgrounds of Hu and Premier Wen Jiabao differ radically from those of Jiang and former Premier Zhu Rongji. Jiang and Zhu spent much of their pre-Beijing careers in the go-go coastal city of Shanghai, where their official duties included hosting foreign business bigwigs. Hu and Wen, by contrast, spent years in the poorest, most remote provinces, including Guizhou, Gansu, and the autonomous region of Tibet, where they had little contact with foreign investors and struggled to lift incomes in the sometimes restive hinterland.

Hu and Wen are staking their reputations on being populists, despite their sometimes heavy-handed ways. They rarely meet with foreign CEOs, unlike their predecessors. Instead, the detail-oriented technocrat Hu—who by all accounts is very smart—has focused more on domestic economic policies. He and his team have offered preferential taxes to boost development in northeastern and western China, reined in real estate markets, and curtailed loans to temper the torrid growth on the coast.

"PEOPLE-CENTERED"

NOW, HU's government, in a bid to alleviate the burden on the poor even further, is considering raising the threshold for income taxes. Says Cheng Li, a professor of government at Hamilton College in Clinton, N.Y.: "He has moved China from GDP-driven growth to people-centered growth." That shift could prove crucial given the rising pressures on Chinese society. According to official estimates, some 74,000 major protests involving 3.7 million Chinese took place last year. Workers, farmers, and even retired soldiers are taking to the streets. Fear of unrest by laid-off workers is one reason Beijing is unlikely to move fast with the further revaluations of the yuan that Washington seeks. Hu's caution is "motivated by [worries about] increasing social tensions," says Shi Yinhong, a professor of international relations at People's University in Beijing.

It's also a reflection of the fact that Hu is still consolidating his power. Six of the nine members of the Politburo Standing Committee owe their positions to Jiang, so Hu must tread carefully during this first of what will almost certainly be two five-year terms. "He's going to be restrained in the near term so he can retain

influence, put in place people he can trust, and deflect potential criticism from more conservative elements," says Bates Gill, a scholar at the Center for Strategic & International Studies in Washington.

Hu and Wen are also proving less reflexively pro-Western than the exuberant Jiang, who once donned a tricornered hat when visiting Philadelphia. While Jiang relished his meetings with U.S. Presidents, he ultimately was accused of being too willing to compromise with the West, particularly when he and Zhu agreed to throw open China's economy to enter the World Trade Organization.

RACE FOR ENERGY

BY CONTRAST, Hu and Wen have spent a great deal of time cultivating relations with less developed countries. China's so-called "good neighbor policy" has opened its market to imports from Southeast Asia and strengthened Beijing's influence in the region. Hu has traveled extensively in the European Union, Russia, Central Asia, Latin America, and Africa. "His diplomacy is more aggressive than Jiang's. He has been more active in pursuing trade deals in Asia," says Nicholas R. Lardy, a China hand at the Institute for International Economics. These efforts challenge Washington's position in key regions, particularly Asia and Latin America. China has replaced the U.S. as the biggest market for countries such as South Korea. Trade between China and Latin America is soaring.

Hu's economic diplomacy is part of China's frantic race to lock up future supplies of energy—also a source of tension with Washington. China's dependence on foreign oil is expected to jump from about 42% now to 67% by 2020. Under Jiang, China inked energy deals with Australia and Africa, but Hu has been stepping up the pace. After his visit to Washington, Hu is expected to head for Canada to discuss natural resource cooperation, among other issues. More irritating to Washington, Beijing is cultivating closer relations with oil-rich nations that the U.S. would like to isolate, including Burma, Iran, Sudan, and Venezuela. "Energy concerns in many ways now dominate China's strategic thinking," says Zhu Feng, director of the International Security Program at Beijing University.

China has aggressively cultivated ties with less developed nations

China really touched a raw nerve in June, when state-owned oil giant CNOOC Ltd. made a bid for U.S. oil producer Unocal Corp. The Chinese leadership is still smarting from the ferocious congressional reaction, which prompted the company to withdraw its offer. Hu is hoping he can convince Washington that China's push for energy resources overseas should not be feared. He also wants to discuss ways the two sides can cooperate on energy efficiency and the use of renewables. He will remind Americans that they and their companies benefit from the two countries' economic relationship, whether in lower prices for clothing or access to the fast-growing mainland market. "You can see that the Chinese people are quite able to accept the U.S. presence in our economy," says a Chinese official.

It's not clear how Bush will react to Hu's arguments: The White House has kept its expectations for the meeting under wraps. In fact, the buzz in Washington is that the Administration has been playing down the visit's importance since the burst of anti-Chinese sentiment over the CNOOC bid and the debate over surging Chinese textile imports. The Chinese are calling the occasion a state visit, while the White House is not.

Some critics argue that the Bush Administration's China policy has been drifting, partly because of the focus on Iraq and partly because Washington needs China to play a key role in persuading North Korea to give up its nuclear weapons program. "There is an attempt at the most senior levels to paper over problems, but they're not going to go away," complains Michael R. Wessel, a member of the U.S.-China Economic and Security Review Commission, which is charged by Congress to make recommendations on U.S.-China policy.

Wessel and other commission members worry about everything from China's longtime violations of intellectual property rights to rising military spending. The Pentagon recently pegged China's de-

What Hu Wants

ENERGY SECURITY Hu aims to assure Washington that Chinese deals such as oil giant CNOOC's failed bid for Unocal aren't a threat to the U.S.

LIKELY OUTCOME Tension over energy competition should ease in the short term, partly because China is unlikely to try any more U.S. energy deals soon.

RETALIATION-FREE TRADE A flood of apparel imports from China is raising U.S. hackles. To ease tensions, Beijing has announced deals to buy Boeing planes and Hu may push for an end to U.S. limits on high-tech exports to narrow this year's $200 billion U.S. trade deficit with China.

LIKELY OUTCOME The U.S. will probably not lift controls.

TAIWAN China wants the U.S. to stop selling advanced weaponry to Taiwan and end high-level military talks between Washington and Taipei.

LIKELY OUTCOME Although talks were delayed until after this meeting, they will soon resume, and military sales will continue.

What Bush Wants

PRESSURE ON NORTH KOREA Washington wants Beijing to lean on Pyongyang to give up its nuclear program in six-party talks hosted by China.

LIKELY OUTCOME Beijing doesn't want nukes in North Korea—but isn't likely to tighten the economic screws for fear of a government collapse and a flood of refugees.

FAIR TRADE The U.S. would like China to crack down on intellectual-property piracy. Washington also will press China to comply with all its obligations under the WTO and help move forward on the Doha round of multilateral trade talks.

LIKELY OUTCOME Don't expect much progress on either front.

STRONG YUAN The Treasury Dept. welcomed China's move to revalue its currency by 2.1% in July. But the U.S. wants bolder steps to help reduce the trade deficit.

LIKELY OUTCOME Concerned about jobs and social stability, China is unlikely to make major moves soon and will revalue very gradually.

nse spending at some $90 billion, ore than three times the $29.9 billion)05 budget figure disclosed by China. the report is right, the mainland is the ird-largest defense spender. Only the .S. and Russia spend more.

HE HAWKS CIRCLE

NOTHER VOLATILE ISSUE is the mas-ve U.S. trade deficit with China, which expected to reach $200 billion this ar. Hu's Boeing deals and possible estinghouse contract are aimed at de-cting attention from the deficit—and 'll probably succeed at least for the ration of his U.S. trip. He will also ush for an end to U.S. restrictions on gh-tech exports to China, arguing that is would also help ease the deficit, al-ough he's unlikely to win that conces-on. On currency, it would be difficult r Bush to criticize Hu too harshly after e Treasury Dept. reacted positively to ijing's move to revalue the yuan by 1% in July. Don't expect Hu to an-ounce another revaluation while in ashington, either. That would be eeted poorly at home since it would be en as hurting already fragile social ability. And Hu wouldn't want to ap-ar to be bowing to U.S. pressure.

Hu may well fly away from Washing-n with a public relations victory to ke back to Beijing. But any lessening tensions is likely to be temporary un-ss he and Bush figure out a modus erandi for dealing with economic oblems. (Ironically, the issue that ually divides Beijing and Washing-n—the question of Taiwan—is not a y source of irritation right now.)

As China hawks in Congress return to apitol Hill, the pressure is likely to ow on the Administration to take a ugher line. "China has 40% of the U.S. ade deficit. There is going to be more ction. That is guaranteed," says avid A. Wyss, chief economist at Stan-rd & Poor's. This fall, the Senate may te on a bill by Senators Charles E. chumer (D-N.Y.) and Lindsey Graham R-S.C.) that would threaten punitive riffs on Chinese imports unless Bei-ng sharply revalues the yuan. The easury Dept. may also step up its crit-ism of China in its semi-annual report n currency regimes in October. With e two economies increasingly inter-vined, managing U.S.-China ties will emand thoughtful, determined states-anship by both Bush and Hu. ■

–By Dexter Roberts in Beijing and Brian Bremner in Tokyo, with Stan rock in Washington, and bureau reports

MARKETS

A CHINESE BANQUET FOR NASDAQ

The exchange is outpacing major rivals in lining up new listings from the mainland

WHEN CHINESE wireless-services provider Hurray! Holding Co. decided it wanted to raise $70.5 million in the equity markets earlier this year, it went right to NASDAQ. Why? Key reasons were NASDAQ's global reputation as the market for the tech world and its fondness for smaller, less-tested companies. "NASDAQ is a key exit [vehicle] for the entrepreneurs and investors that finance these companies," says Steven L. Toronto, managing partner of the Beijing office of Morrison & Foerster, a San Francisco law firm that helped Hurray on its way.

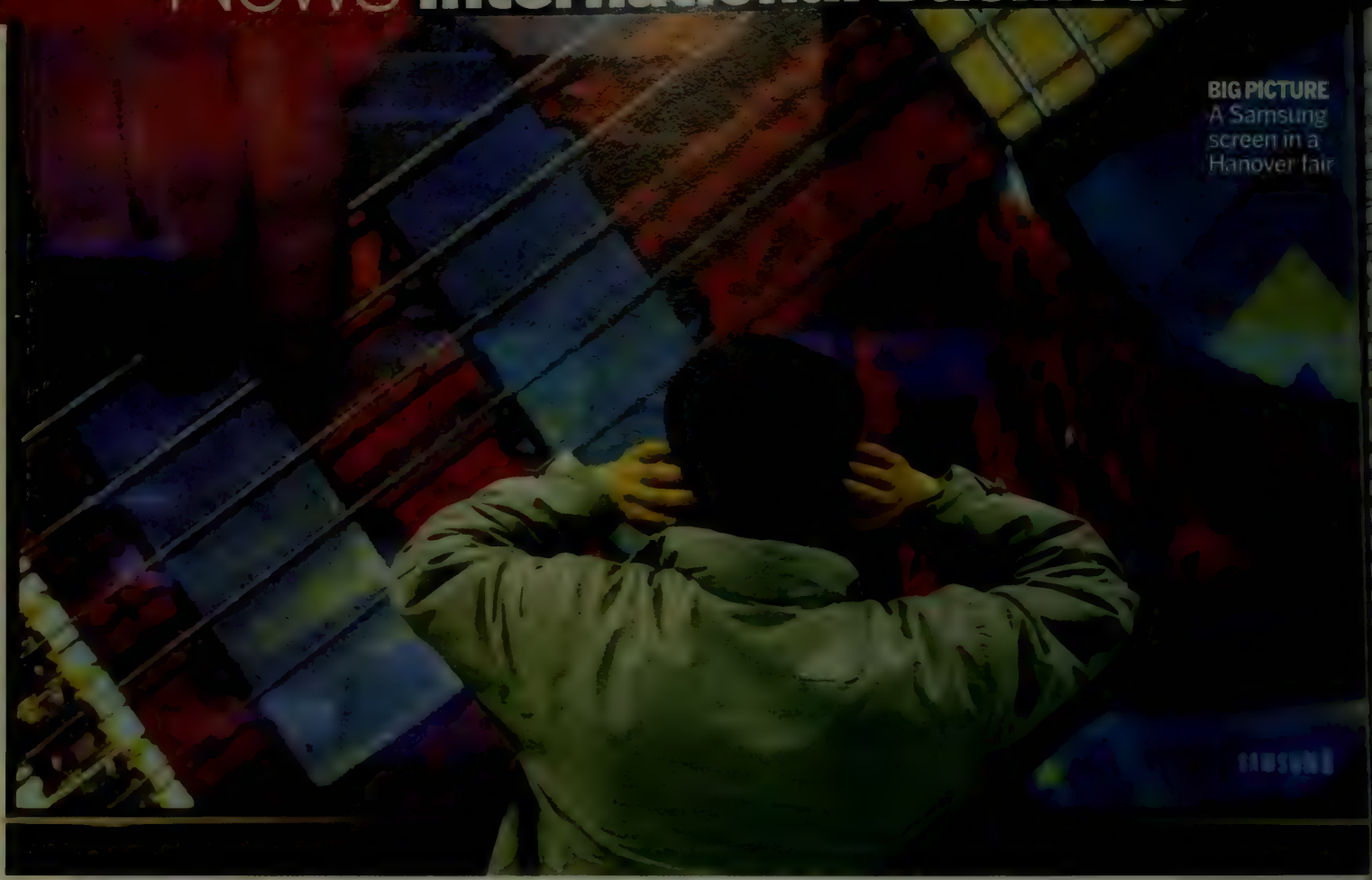
The New York Stock Exchange, the London Stock Exchange, and New York-based NASDAQ are all in hot pursuit of fresh listings of fast-growth Chinese companies. The NYSE will open a new office in Beijing in October. But NASDAQ has outpaced its rivals. Since the beginning of 2004 it has signed up 16 Chinese companies. Its biggest coup by far: Baidu.com Inc., the Beijing-based Internet search-engine firm that went public on NASDAQ Aug. 4 at $27 per American Depositary Receipt, climbed to $154, and now trades at about $83.

BIG COUP Baidu went public at $27. Now it trades at $83

The NYSE can claim just two new listings in the same period. The LSE has added 12, all but one on its NASDAQ-like Alternative Investment Market. NASDAQ's success has made it a force in China. "Ten years ago nobody actually knew NASDAQ," says Lawrence Pan, a former Morgan Stanley investment banker who took the helm of NASDAQ's China operations in March. "Right now there's a lot of awareness."

For its part, the regal NYSE sniffs at its competitor's success, pointing out that only a handful of the Chinese outfits on NASDAQ would meet the exchange's higher financial standards. The NYSE further notes that together the businesses boast a total market cap of just $18 billion, compared with $335 billion for the 16 mainland Chinese companies listed on the Big Board. That's because the NYSE mostly lists giant, state-controlled enterprises such as China Telecom and PetroChina. The NYSE is pursuing "world-class companies that compete with other world-class companies," says Catherine R. Kinney, NYSE president. Nonetheless, it's worth noting that after the NYSE completes its merger with Chicago's Archipelago Exchange by early next year, it plans to create an all-electronic alternative for smaller companies—like Hurray and Baidu. ■

–By Joseph Weber in Chicago, with Brian Bremner in Hong Kong



BIG PICTURE A Samsung screen in a Hanover fair

ASIA

WAR OF THE SCREENS

As LCD makers gear up to make bigger, cheaper, flat-panel displays, the plasma kings vow to fight back

STANDING ON A BARREN patch of ground in the South Korean town of Paju is a new factory so gigantic that it could hold eight soccer stadiums. The exterior of the 200-foot-tall facility is finished, and heavy-duty trucks and cranes are moving in multi-million-dollar robots and other equipment. When completed by the end of this year at a cost of $5 billion, the factory, owned by LG.Philips LCD Co., will be the world's largest maker of liquid-crystal display panels, the main building block for LCD flat-panel televisions. Paju will be a so-called seventh-generation (G7) plant, capable of churning out sheets of specialized glass some 77 inches by 89 inches in size, far bigger than those produced by earlier generations of plants.

PLUMMETING PRICES

THE FACTORY AT PAJU is one part of a huge arsenal, an arsenal being built at breakneck speed by the Koreans, Japanese, and Taiwanese in the fight to own the global television market. LG.Philips plans to spend a total of $25 billion in the next decade at Paju, where it will expand its G7 plant eightfold. Samsung Electronics, meanwhile, will spend $20 billion to build out its LCD panel operation in Tangjeong, Korea. Japan's Sharp is erecting a $1.4 billion plant that will make even bigger LCD glass panels than Paju when it opens in October, 2006. The Taiwanese—Au Optronics Corp., Chi Mei Optoelectronics Corp., and others—are not far behind in the arms race.

This buildup in Korea and beyond has huge implications for the televisions we'll all be watching over the next decade. The bigger the glass sheet an LCD plant can produce, the more flat panels for TVs it can punch out of the sheet. Not only more TV panels but bigger ones as well: Technicians can punch out eight 42-inch panels from a G7 glass sheet, as opposed to three from a G6 sheet.

The resulting gain in productivity is

aking up the TV industry. Average ices of smaller, 20-inch LCD TVs have ready tumbled from more than $5,000 2000 to under $600 today, as each new eneration of plants introduces efficien- es and lower costs. The price drops have panded the market for flat-panel TVs, hich is expected to double this year, to 5.6 million units worldwide, according researcher DisplaySearch. Profits have eakened as new supply comes on line, ut analysts expect an earnings rebound r LCD TVs next year.

The arrival of the G7 plants means hu- ongous flat-panel LCD TVs could soon ecome affordable—not just high-priced ys for the rich. Analysts and display-in- ustry executives expect the price of a 42- ch LCD TV to fall to under $1,500 in the ext three years, from $2,900 at yearend 005. "Our new-generation factory is en- bling enough volume to support a mass arket of large-screen TVs," says Bruce erkoff, marketing chief of LG.Philips, a int venture between Korea's LG Elec- onics and the Netherlands' Philips lectronics.

The democratiza- on of big, thin-screen Vs will help create so- histicated home cine- as for families round the globe. But s LCDs move up in size, what does that ean for the plasma TVs that now domi- ate the big-screen category? LCDs rely n light-polarizing crystals for their effect, hile plasma displays employ tiny pock- ts of glowing gas to produce images on a hin screen. Plasma TVs have ruled the arket for screens 40 inches and larger ecause until now LCD makers ran into uality problems when they tried to make arger screens. The plasma makers, in urn, could not go down in size because lasma screens tend to lose brightness as hey shrink. Plasma TVs at larger sizes ave also been cheaper to make, since the lass needed is less sophisticated and less ostly than the glass in LCD panels.

But now that LCDs are getting larger, hey pose a big threat to companies such s Matsushita Electric Industrial Co. Panasonic) and Pioneer Corp. of Japan hat have flourished making big plasma creens. "You can expect a grueling fight etween LCD and plasma next year in the 40-inch segment," says Duke Koo, execu- ive vice-president in charge of global ales for LG.Philips.

Plasma TV makers now control 88% of he market for 40-inch-plus, thin-screen elevisions, and they are not about to con- ede a single pixel. Matsushita, which commands a quarter of the global plasma TV market, just spent $860 million on a new television plant in western Japan that will open in October. Matsushita projects that it will sell 2.1 million plasma TVs this year. Pioneer, which has an 8% market share, is also increasing production.

Some $21 billion in thin-screen TVs were sold in 2004

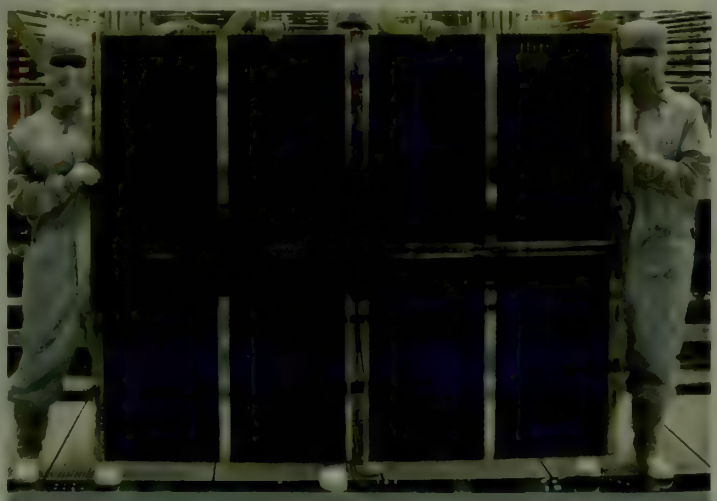
Because plasma is a cheaper technology, plasma TV makers—as they expand capacity—have been easily able to match the LCD crowd's price reductions. The price of a 42-inch plasma set, which should hit $1,800 by yearend, is expected to fall to $1,150 by 2007. Moreover, plasma manufacturers insist that at bigger sizes, LCD televisions are afflicted with color and image distortion. "Plasma TVs can be watched from different angles without losing clarity," says Masaaki Fujita, the head of Matsushita's plasma TV division. "For a family that watches movies together, that's important." LCD makers respond that among the better brands, the problems of color distortion and "motion blur" have been resolved, and that LCD TVs use less power and last longer.

At stake are billions of dollars in revenues and profits. Some $21 billion worth of thin-screen televisions were sold in 2004. The competition is already heating up. On Aug. 1, Sharp Corp.—Japan's biggest player in LCDs—began selling a 65-inch LCD TV in its home market for $14,500. Sharp plans to ship it to other countries before yearend. Then, on Aug. 25, Matsushita in Tokyo introduced its Panasonic high-definition Viera 65-inch plasma set, which will sell for about $9,000 when it comes on the market later this year.

Despite the brave face it puts on, the plasma TV industry has had to give up the 32-inch market to LCD makers. In the end, plasma may be confined to sets of 50 inches or more. "I think it quite probable LCD will have an [overall] edge after three years, given its economies of scale," says analyst Daniel Kim of Merrill Lynch & Co.

How so? While plasma screens are used mostly for televisions, the LCD industry churns out displays for 200 million computers each year, as well as for millions of cell phones, personal digital assistants, digital audio players, and cameras. "Profits from notebooks, monitors, and mobile devices give us resources to keep investing in next-generation plants," says Cho Yeong Duk, Samsung Electronics' vice-president in charge of LCD business strategy. Plants that will revolutionize the industry. ■

–By Moon Ihlwan in Seoul and Kenji Hall in Tokyo



LG.PHILIPS PANEL The company's new LCD plant cost $5 billion

Glass Action

The glass sheets used to make LCD TV screens are getting bigger with each new generation of factories. That makes larger screen sizes possible and dramatically reduces the cost of TVs.

	2000	2005
Biggest glass sheet:	27" x 35"	74" x 87"
Largest LCD TV manufactured:	22"	65"
Average retail cost of 20" LCD TV:	$5,139*	$563

*January, 2001
Data: LG.Philips LCD, NPD Group, Samsung Electronics

FRANCE

MICHELIN TAKES A BITE OF THE BIG APPLE

In its first transatlantic foray, the red guide will cross forks with Zagat

IN TIMES SQUARE Bibendum, the Michelin man

FOR ALMOST A CENTURY, chefs in France have wept into their pâté en croûte over the loss or gain of a star in the Michelin Guide. And not only French chefs. The legendary "red book" put out by French tire company Michelin now comes in 12 regional editions that rate restaurants from London to Portugal. "It's the gold standard of European food guides," says New York celebrity chef Anthony Bourdain.

Now the legend is set to cross the Atlantic. In November, Michelin will publish its first U.S. edition, a selection of 500 top-notch New York City restaurants and hotels. "Today the city has some of the best chefs from around the world. We can't not be there," says Jean-Luc Naret, the guides' worldwide director.

This time, Bibendum, better known as the Michelin man on American shores, is up against some tough competition. Gotham is Zagat country. Some 650,000 copies of Zagat's guide to New York City dining were sold last year, compared with 415,000 Michelin guides to the restaurants and hotels of France. While Michelin employs highly trained "inspectors" and guards their anonymity, Zagat relies on reports submitted by readers. "Our guide is based on the collective experiences of thousands of restaurant-savvy New Yorkers," says Curt Gathje, editor of Zagat's 2006 edition. Michelin's more costly methods are reflected in the $29 cover price for the voluminous French guide. The New York City version will be priced at $16.95, competitive with Zagat's $13.95.

For the Big Apple, the guide gets a facelift. The European format bestows two-sentence reviews on each restaurant, but the New York edition will feature photos and descriptions as long as two pages. John Bowen, partner at Publicis Groupe's BOS Group, a marketing consultancy, believes Michelin will build a following: "There is a belief in New York that the city can't be comprehended by anyone but New Yorkers, but Michelin has great credibility with global travelers."

Nonetheless, keeping pace with the city that never sleeps may prove a challenge. For $19.95 a year, obsessive foodies can subscribe to Zagat's online service and get monthly e-mail updates of the newest hot spots. Visitors to ViaMichelin.com can access reviews free of charge, but content is updated annually.

Given the competition, will Michelin make a bundle in the Big Apple? The guides generate a small fraction of the tiremaker's $19 billion in overall sales. Still, the company believes the red books add priceless prestige to the brand. Back home, however, the guide's luster has been tarnished of late. Colleagues and friends of French *über*chef Bernard Loiseau believe that rumors he was about to be demoted to two stars led to his suicide in 2003. In May Parisian chef Alain Senderens announced he would downscale his three-star menu at Lucas Carton because he was exhausted from the pressure of living up to the rating. A 2004 memoir by veteran inspector Pascal Rémy said that Michelin bows to lobbying from top chefs and fails to inspect restaurants for each new edition. The company admits its inspectors don't visit each restaurant every year, but denies that it is influenced by lobbying.

Sales of the red guide also declined 7% last year in France, partly because diners have been switching to online review sites, including Michelin's. But Michelin still fared better than the overall European guide book industry, which saw 2004 sales slide 10%. "The French like to shoot down icons, but our guides are still going strong," says Emmanuel Penicaud, president of the maps and guides division.

Michelin expects to sell 80,000 to 300,000 copies of the New York red book the first year. In the meantime, New York's top chefs can only wring their aprons as they wait to see which establishments bagged a three-star rating. Who's the smart money on? Per Se, where Thomas Keller cooks up a mean dish of Island Creek oysters, pearl tapioca, and Osetra caviar; Masa, a hyper-exclusive Japanese restaurant; and seafood star Le Bernardin. ■

–By Rachel Tiplady in Paris, with David Kiley in New York

Gourmands in Gotham

The Michelin man faces serious competition in New York City

Number of copies sold in 2004

Zagat New York City restaurant guide
650,000

Michelin Guide to France
415,000

Data: Michelin, Zagat

new

Peaceful, restful sleep.

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(eszopiclone)©
1, 2 AND 3 MG TABLETS

Introducing Lunesta,™ a brand new sleep aid that can change your nights.

Even when your restless mind keeps you awake, brand new Lunesta can give your body and mind the soothing sleep you need. Lunesta not only helps most people fall asleep fast, it helps you sleep all through the night. Peacefully, uninterrupted. Lunesta works quickly, so you should only take it right before bed. And Lunesta is non-narcotic, and approved for long-term use. Of course, do not use sleep medicines for extended periods without first talking to your doctor.

Now's the time to catch the sleep you need. If you've been hesitant to take a prescription sleep aid, be sure to ask your doctor about Lunesta.

Important Safety Information: Be sure you have at least eight hours to devote to sleep before becoming active. Until you know how you'll react to Lunesta, you should not drive or operate machinery. Do not use alcohol while taking Lunesta. All sleep medicines carry some risk of dependency. Side effects may include unpleasant taste, headache, drowsiness and dizziness. *See important patient information on the next page.*

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1, 2 AND 3 MG TABLETS

Please read this summary of information about LUNESTA before you talk to your doctor or start using LUNESTA. It is not meant to take the place of your doctor's instructions. If you have any questions about LUNESTA tablets, be sure to ask your doctor or pharmacist.

LUNESTA is used to treat different types of sleep problems, such as difficulty in falling asleep, difficulty in maintaining sleep during the night, and waking up too early in the morning. Most people with insomnia have more than one of these problems. You should take LUNESTA immediately before going to bed because of the risk of falling.

LUNESTA belongs to a group of medicines known as "hypnotics" or, simply, sleep medicines. There are many different sleep medicines available to help people sleep better. Insomnia is often transient and intermittent. It usually requires treatment for only a short time, usually 7 to 10 days up to 2 weeks. If your insomnia does not improve after 7 to 10 days of treatment, see your doctor, because it may be a sign of an underlying condition. Some people have chronic sleep problems that may require more prolonged use of sleep medicine. However, you should not use these medicines for long periods without talking with your doctor about the risks and benefits of prolonged use.

Side Effects

All medicines have side effects. The most common side effects of sleep medicines are:

- Drowsiness
- Dizziness
- Lightheadedness
- Difficulty with coordination

Sleep medicines can make you sleepy during the day. How drowsy you feel depends upon how your body reacts to the medicine, which sleep medicine you are taking, and how large a dose your doctor has prescribed. Daytime drowsiness is best avoided by taking the lowest dose possible that will still help you sleep at night. Your doctor will work with you to find the dose of LUNESTA that is best for you. Some people taking LUNESTA have reported next-day sleepiness.

To manage these side effects while you are taking this medicine:

- When you first start taking LUNESTA or any other sleep medicine, until you know whether the medicine will still have some effect on you the next day, use extreme care while doing anything that requires complete alertness, such as driving a car, operating machinery, or piloting an aircraft.
- Do not drink alcohol when you are taking LUNESTA or any sleep medicine. Alcohol can increase the side effects of LUNESTA or any other sleep medicine.
- Do not take any other medicines without asking your doctor first. This includes medicines you can buy without a prescription. Some medicines can cause drowsiness and are best avoided while taking LUNESTA.
- Always take the exact dose of LUNESTA prescribed by your doctor. Never change your dose without talking to your doctor first.

Special Concerns

There are some special problems that may occur while taking sleep medicines.

Memory Problems

Sleep medicines may cause a special type of memory loss or "amnesia." When this occurs, a person may not remember what has happened for several hours after taking the medicine. This is usually not a problem since most people fall asleep after taking the medicine. Memory loss can be a problem, however, when sleep medicines are taken while traveling, such as during an airplane flight and the person wakes up before the effect of the medicine is gone. This has been called "traveler's amnesia." Memory problems have been reported rarely by patients taking LUNESTA in clinical studies. In most cases, memory problems can be avoided if you take LUNESTA only when you are able to get a full night of sleep before you need to be active again. Be sure to talk to your doctor if you think you are having memory problems.

Tolerance

When sleep medicines are used every night for more than a few weeks, they may lose their effectiveness in helping you sleep. This is known as "tolerance." Development of tolerance to LUNESTA was not observed in a clinical study of 6 months' duration. Insomnia is often transient and intermittent, and prolonged use of sleep medicines is generally not necessary. Some people, though, have chronic sleep problems that may require more prolonged use of sleep medicine. If your sleep problems continue, consult your doctor, who will determine whether other measures are needed to overcome your sleep problems.

Dependence

Sleep medicines can cause dependence in some people, especially when these medicines are used regularly for longer than a few weeks or at high doses. Dependence is the need to continue taking a medicine because stopping it is unpleasant.

When people develop dependence, stopping the medicine suddenly may cause unpleasant symptoms (see *Withdrawal* below). They may find they have to keep taking the medicine either at the prescribed dose or at increasing doses just to avoid withdrawal symptoms.

All people taking sleep medicines have some risk of becoming dependent on the medicine. However, people who have been dependent on alcohol or other drugs in the past may have a higher chance of becoming addicted to sleep medicines. This possibility must be considered before using these medicines for more than a few weeks. If you have been addicted to alcohol or drugs in the past, it is important to tell your doctor before starting LUNESTA or any sleep medicine.

Withdrawal

Withdrawal symptoms may occur when sleep medicines are stopped suddenly after being used daily for a long time. In some cases, these symptoms can occur even if the medicine has been used for only a week or two. In mild cases, withdrawal symptoms may include unpleasant feelings. In more severe cases, abdominal and muscle cramps, vomiting, sweating, shakiness, and, rarely, seizures may occur. These more severe withdrawal symptoms are very uncommon. Although withdrawal symptoms have not been observed in the relatively limited controlled trials experience with LUNESTA, there is, nevertheless, the risk of such events in association with the use of any sleep medicine.

Another problem that may occur when sleep medicines are stopped is known as "rebound insomnia." This means that a person may have more trouble sleeping the first few nights after the medicine is stopped than before starting the medicine. If you should experience rebound insomnia, do not get discouraged. This problem usually goes away on its own after 1 or 2 nights.

If you have been taking LUNESTA or any other sleep medicine for more than 1 or 2 weeks, do not stop taking it on your own. Always follow your doctor's directions.

Changes In Behavior And Thinking

Some people using sleep medicines have experienced unusual changes in their thinking and/or behavior. These effects are not common. However, they have included:

- More outgoing or aggressive behavior than normal
- Confusion
- Strange behavior
- Agitation
- Hallucinations
- Worsening of depression
- Suicidal thoughts

How often these effects occur depends on several factors, such as a person's general health, the use of other medicines, and which sleep medicine is being used. Clinical experience with LUNESTA suggests that it is rarely associated with these behavior changes.

It is also important to realize it is rarely clear whether these behavior changes are caused by the medicine, are caused by an illness, or have occurred on their own. In fact, sleep problems that do not improve may be due to illnesses that were present before the medicine was used. If you or your family notice any changes in your behavior, or if you have any unusual disturbing thoughts, call your doctor immediately.

Pregnancy And Breastfeeding

Sleep medicines may cause sedation or other poten effects in the unborn baby when used during the last we of pregnancy. Be sure to tell your doctor if you are pregn if you are planning to become pregnant, or if you beco pregnant while taking LUNESTA.

In addition, a very small amount of LUNESTA may be pres in breast milk after use of the medication. The effects of small amounts of LUNESTA on an infant are not kno therefore, as with all other prescription sleep medicines, recommended that you not take LUNESTA if you are bre feeding a baby.

Safe Use Of Sleep Medicines

To ensure the safe and effective use of LUNESTA or any ot sleep medicine, you should observe the following cautio

1. LUNESTA is a prescription medicine and should used ONLY as directed by your doctor. Follow y doctor's instructions about how to take, when to ta and how long to take LUNESTA.
2. Never use LUNESTA or any other sleep medicine longer than directed by your doctor.
3. If you notice any unusual and/or disturbing thoug or behavior during treatment with LUNESTA or a other sleep medicine, contact your doctor.
4. Tell your doctor about any medicines you may taking, including medicines you may buy withou prescription and herbal preparations. You should a tell your doctor if you drink alcohol. DO NOT use alco while taking LUNESTA or any other sleep medicine
5. Do not take LUNESTA unless you are able to get 8 more hours of sleep before you must be active aga
6. Do not increase the prescribed dose of LUNESTA any other sleep medicine unless instructed by y doctor.
7. When you first start taking LUNESTA or any oth sleep medicine, until you know whether the medici will still have some effect on you the next day, u extreme care while doing anything that requir complete alertness, such as driving a car, operat machinery, or piloting an aircraft.
8. Be aware that you may have more sleeping proble the first night or two after stopping any sleep medic
9. Be sure to tell your doctor if you are pregnant you are planning to become pregnant, if you becom pregnant, or if you are breastfeeding a baby wh taking LUNESTA.
10. As with all prescription medicines, never sha LUNESTA or any other sleep medicine with anyo else. Always store LUNESTA or any other sleep medic in the original container and out of reach of childre
11. Be sure to tell your doctor if you suffer from depressio
12. LUNESTA works very quickly. You should only ta LUNESTA immediately before going to bed.
13. For LUNESTA to work best, you should not take it wi or immediately after a high-fat, heavy meal.
14. Some people, such as older adults (i.e., ages 65 a over) and people with liver disease, should start wi the lower dose (1 mg) of LUNESTA. Your doctor m choose to start therapy at 2 mg. In general, adul under age 65 should be treated with 2 or 3 mg.
15. Each tablet is a single dose; do not crush or bre the tablet.

Note: This summary provides important information abo LUNESTA. If you would like more information, ask yo doctor or pharmacist to let you read the Prescribin Information and then discuss it with him or her.

Rx only

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DITED BY CRISTINA LINDBLAD

Will Scandal Spare Lula But Kill Reform?

HE CORRUPTION SCANDAL engulfing the government of President uiz Inácio Lula da Silva has more plot twists than a *telenovela*, ne TV soap operas Brazilians are so addicted to. It all began in Iay when a post office official was caught on video pocketing a 1,250 bribe. Then came the explosive allegation that members the ruling Workers' Party (PT) were paying gislators of other parties $12,500 a month r their votes. Since then fresh accusations ve emerged almost daily—from the PT ofial caught trying to board a plane with 00,000 in his underpants to the "event orinizer" who allegedly procured call girls r politicians from the PT and other parties.

Among the most damaging accusations that Lula's economic czar, Antonio locci, took kickbacks for the PT from aste-hauling companies while serving as ayor of a city in São Paulo state in the id-1990s. Those allegations, aired on ug. 19 and denied by Palocci, hammered azilian securities and e currency, although ost of the losses were ickly reversed.

The damage to Lula's lministration may be rder to repair. Oppoion parties lack the idence to launch imachment proceedgs against Lula, and ey are mindful that ing so would imperil razil's hard-won fiancial stability. But ula's chances of pushg through reforms eeded to keep the onomy growing, such as a simplification the tax system and a revamp of the rigid bor code, are slim, as legislators start elving into the corruption mess.

LIMPING ON The support he needs in Congress is evaporating

Remarkably, South America's biggest onomy has so far managed to avert a fiancial meltdown. Wall Street has rugged off the political crisis, focusing stead on the fact that Brazil's economy is better shape than it has been in decades. he country is running a budget surplus in cess of 4% of gross domestic product, excluding debt payments. And the current account is headed for a surplus of $14 billion, vs. an $11 billion deficit in 2002, helped by strong prices for commodity exports such as soybeans and iron ore.

His party's grim future

WITH INTEREST RATES in the U.S. and Europe at historic lows, emerging markets such as Brazil offer richer returns. So investors prefer to focus on the country's economic prospects, overlooking what they regard as mere political noise. "Brazil is on autopilot," says Jerome Booth, head of research at Ashmore Investment Management Ltd. in London. "Congress could do nothing for the next year, and Brazil would still be a good credit."

But the crisis could have implications that would eventually affect the markets. Lula may yet limp on to secure a second term in national elections scheduled for October, 2006. But the future looks grim for the PT, with several high-level officials forced to step down as a result of the scandal. Without a solid core of supporters in Congress, Lula's ability to govern would dwindle.

That's a concern since Brazil needs a strong leader to press ahead with difficult structural reforms to boost the economy's long-term growth potential. "A Lula victory in 2006 would deliver two years of crisis followed by four years of weak government," says José Luciano Dias of IBEP, a political consultancy in Brasília. For the 52 million voters who put their faith in Lula—and even investors—that would be harder to take than the worst *telenovela*. ■

–By Jonathan Wheatley in São Paulo

GLOBAL WRAPUP

PARIS FENCES OFF STRATEGIC INDUSTRIES

FRANCE'S center-right government said on Aug. 31 that it will block foreign acquisitions of French companies in 10 "strategic" industries, including defense, military-related technologies, biotechnology, information security, and the casino business. But the government declined to extend such protection to major French companies, such as food producer Groupe Danone and metals company Eramet, that have been mentioned recently as possible takeover targets. Although many French politicians wanted to offer protection to a wider range of industries, European Union regulators probably would have overruled such a move. Nevertheless, the anti-takeover provisions would apply to such well-known companies as telecom group Alcatel and hotel operator Accor, because of its ownership of casinos.

TCL'S FRENCH MEAL LEADS TO INDIGESTION

AS CHINESE companies like Lenovo, Haier, and CNOOC look to expand through overseas acquisitions, the company behind one of the earliest high-profile Chinese deals is struggling. Television maker TCL Multimedia, which last year took control of the RCA brand as part of its acquisition of French company Thomson's TV business, reported on Aug. 31 a second-quarter loss of $6 million on sales of $987 million. TCL has had difficulty integrating the Thomson business and was hit by falling margins for flat-screen TVs in the U.S. and a fierce price war in its home Chinese market. TCL management is predicting a turnaround by mid-2006.

Hindsight is easy.

It's thinking ahead that's hard. But that's how Liberty Mutual serves our customers and why we're one of the world's leading groups of insurance companies, with over $19.6 billion in revenue. Over the last 93 years, we've introduced innovative products and services and helped to develop hundreds of groundbreaking safety initiatives through the Liberty Mutual Research Institute for Safety. Along the way, we've learned that helping people reduce risk and prevent accidents is just good business. **IT'S MORE THAN INSURANCE. IT'S INSURANCE *in* ACTION.®**

Liberty Mutual.

libertymutual.com

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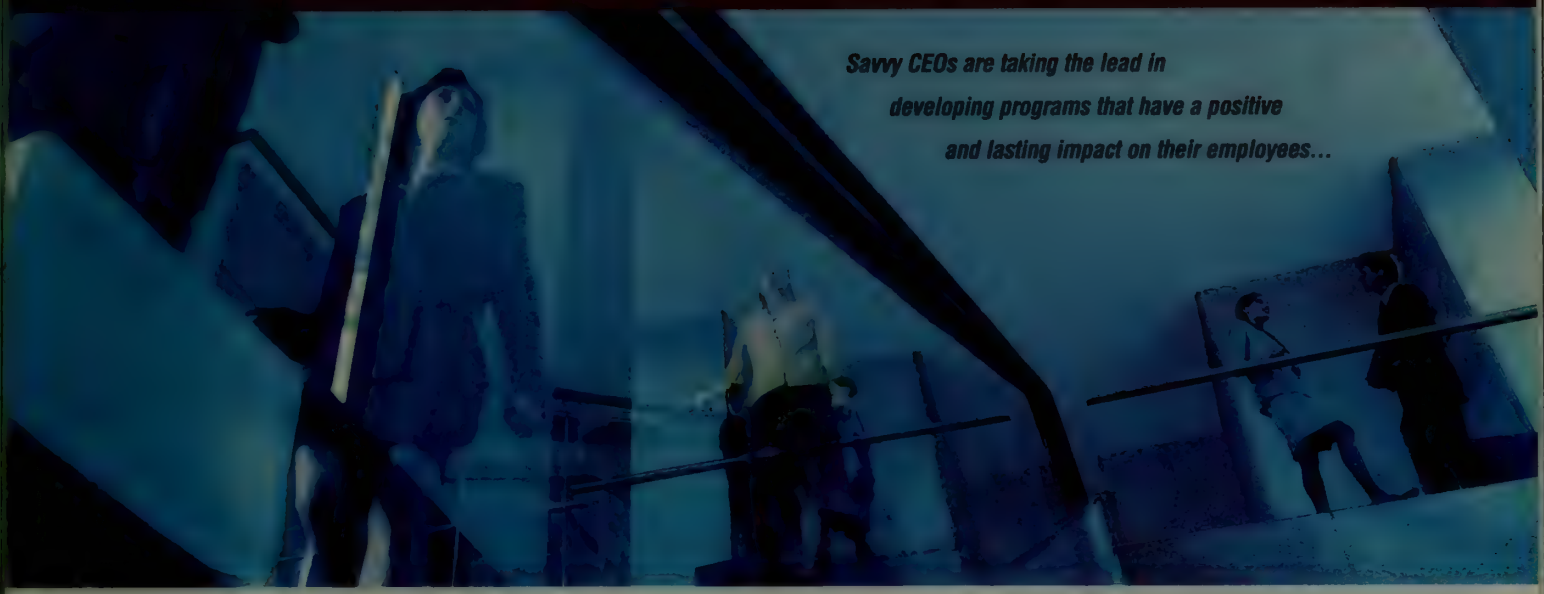
THE ROI OF SAFETY

The bottom line on safety: It starts at the top



Savvy CEOs are taking the lead in developing programs that have a positive and lasting impact on their employees...

In today's intensely competitive business environment, managers must evaluate every product, service or program's contribution to corporate fiscal performance. At the same time, achieving and maintaining competitive advantage often depends on the organization's swift identification of impediments to corporate productivity and fiscal growth.

Increasingly, businesses are discovering that attention to employee safety and health, both on and off the job, positively benefits the workforce as well as the bottom line.

As a nation, we have made considerable progress in dramatically reducing workplace injuries. According to the National Safety Council, deaths from work-related injuries have declined by nearly 70 percent in the last 50 years and by as much as 24 percent in the last 10 years.

But for today's new breed of CEOs, even one injury is too many. More important, they're making the connection between safety as corporate social responsibility and corporate fiscal health. According to the Liberty Mutual Research Institute for Safety, for every $1 invested in safety, there is between a $3 and $6 savings.

"Organizations are beginning to realize that safety pays tremendous dividends in terms of lower workers' compensation and insurance costs, as well as improved employee productivity, morale, and retention," says Alan C. McMillan, president and CEO of the National Safety Council in suburban Chicago.

(continued on next page)

Safety isn't just benefiting the organization's employees, it's benefiting the organization's bottom line as well. An increasing number of CEOs are realizing that investing in safety is a sound business strategy.

Q&A

Alan C. McMillan

President and CEO National Safety Council

What is your organization's mission?
We were founded in 1913 by leaders from industry, government and labor who recognized the need for a permanent body to promote safety in industry and all aspects of our lives. We received a Congressional Charter in 1953 and today, with the support of our 46,000 member organizations, we continue to educate and influence businesses and society to adopt safety and health practices.

How can companies improve employee safety?
By incorporating safety into the organization's leadership philosophy and culture and making safety a core corporate value. Employees must be given the knowledge and training to minimize their risk of injury on and off the job. Finally, safety performance must be measured and integrated into an organization's management systems.

What do you see as the greatest challenge to safety?
Our transformation into a global society. It is incumbent upon all of us to embrace safety and health practices to ensure the well being of workers, families and communities throughout the world.

(Continued from the cover) It's a sentiment shared by senior management at companies on the leading edge of workplace safety. "In the daily hustle and bustle, one can easily forget that a safe business is a well-run business," says Edmund F. Kelly, chairman, president, and CEO of Boston-based Liberty Mutual Insurance Co. "Safety is an investment and not an expense because, apart from any moral or ethical considerations, a safer workplace is more efficient and more economical. As an insurer, we see firsthand the immediate cost of a lack of safety."

> "Even with workplace injuries declining, annual employer costs for injuries to workers while off the job and their family members are increasing."
>
> ALAN C. McMILLAN
> NATIONAL SAFETY COUNCIL

Another company that has seen firsthand the ROI of safety is Exxon Mobil Corporation. "Safety performance is a critical leading indicator of the overall quality and competence of an organization," says Senior Vice President Ed Galante of Texas-based ExxonMobil, whose safety focus has made it the global oil & gas industry leader in most measures of worker safety. "It has been our experience that a disciplined approach to improving safety performance benefits all aspects of our operations. Our focus on safety has also helped us achieve lower costs, better reliability and higher plant utilization, all contributing to the bottom line."

Instilling a Culture of Safety

The companies that have been most successful in harnessing the financial benefits of a safe workplace come from varied business environments but share common traits. Namely, they have CEOs who recognize that a culture of safety must be a core value that imbues every aspect of their organization and that safety must start with them.

"Good business leaders understand human nature, care about each worker's well-being, and recognize that a company's employees are its greatest asset," says McMillan. "For them, employee safety is non-negotiable, uncompromising, permanent."

That's why savvy CEOs are taking the lead in developing programs that have a positive and lasting impact on their employees and that tie into their companies' mission.

"At ExxonMobil, no aspect of work receives greater attention than the safety and health of our workers, customers, and the communities where we do business," says Galante. "We strive for an incident-free workplace and an environment that supports our clear and simple program objective: 'Nobody Gets Hurt.' We mean this. Our management, led by Chairman and CEO Lee Raymond, is committed to driving the rate of injuries and accidents as close to zero as possible."

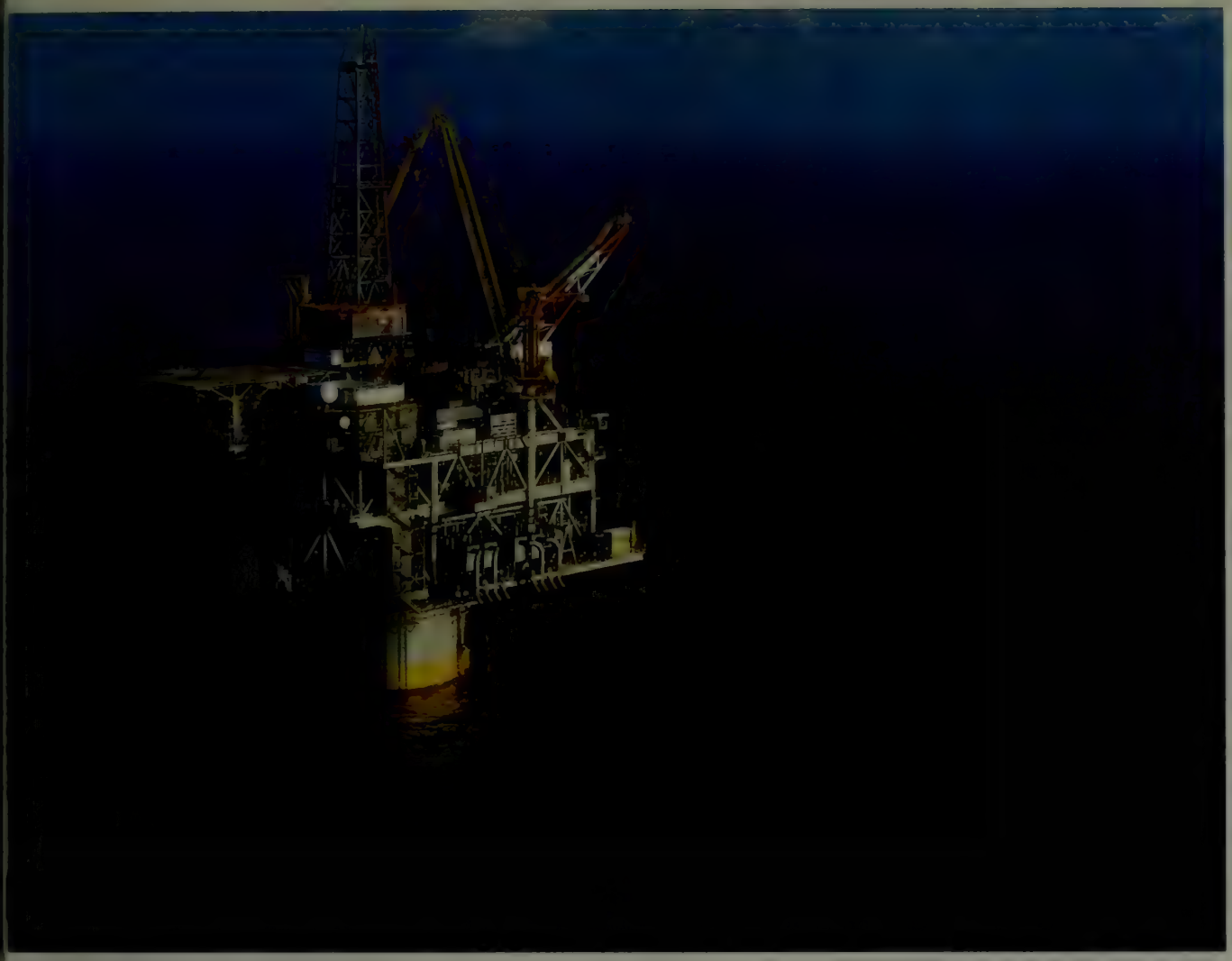
For Liberty Mutual, it's part of its mission statement: helping people live safer, more secure lives. That's why it has implemented policies that back its philosophy.

Web Resources

National Safety Council
www.nsc.org

ExxonMobil
www.exxonmobil.com

Liberty Mutual
www.libertymutual.com



The true measure of a company. A strong commitment to safety, health, and the environment. From setting industry-leading records again last year. To instilling the Operations Integrity Management System, which helps to improve our performance in over 200 countries and territories in which we operate. At ExxonMobil, we believe a company's overall performance can be judged by its achievements in these areas. As part of this effort, we're proud to contribute $1 million to the Robert W. Campbell Award, which honors companies that link outstanding safety, health, and environmental practices with productivity and profitability. And whether it's here, at home, or across the globe, protecting the people we work with and the places where we work will always be fundamental to everything we do. *exxonmobil.com*

ExxonMobil

Taking on the world's toughest energy challenges.™

THE ROI OF SAFETY

The bottom line on safety: It starts at the top

Q&A

Edmund F. Kelly

Chairman, President, and CEO Liberty Mutual

Why is safety so important to your company?
Because keeping people safe is the right thing to do. When Liberty Mutual was founded in 1912, workplace injuries were much more common. Many workers were severely injured or lost their lives, yet companies didn't think to improve safety because they felt workplace accidents were a normal part of business. Today's workplace is considerably safer than it was 90 years ago, but people still get injured.

What role does the Liberty Mutual Research Institute for Safety play?
For the past five decades, the Research Institute has conducted research on how to prevent workplace illnesses and injuries and how to get people healthy and back to work. Our research results are not proprietary nor do they sit on a shelf.

What did receiving the 2005 Green Cross Medal for Safety Medallion mean to your company?
Receiving the award was especially significant to us. With it, the National Safety Council honored the core of our institution, the essence of our tradition and a commitment that really matters to us.

"Enlightened companies and their leadership understand the risk components of their operations, implement appropriate controls, train their employees on the safety protocols specific to their industry, and regularly and rigorously measure their safety record," says Kelly.

And it's not just the large energy and insurance companies that need to be concerned. Every organization is at risk. "If you operate a business, you need to be concerned about safety," says Kelly. "Slipping, tripping, and falling all happen whether your employee is in the office, on the factory floor, or at the construction site. Repetitive motion injury happens to workers on computers as well as on the assembly line. Any management team that ignores safety because they think injuries don't happen in their line of work needs to open their eyes."

Extending the Vision

These incidents not only have a devastating effect on employee morale, they have a negative effect on finances. According to the National Safety Council, of the 100,000 injury-related deaths last year, 64 percent involved workers who were off the job or their family members.

"The cost of on-the-job injuries was $156.2 billion in 2003, of which $78.3 billion was wage and productivity losses," explains McMillan. "That number is compounded by employee off-the-job injuries that cost society an estimated $205.3 billion. That's a staggering annual cost to businesses of $361.5 billion."

> "Employees who work in a safe environment feel valued and are inclined to want to produce a quality product, increase productivity, and make customers happy.
>
> EDMUND F. KELLY
> LIBERTY MUTUAL

These statistics help explain one of the National Safety Council's recent initiatives: to call attention to the issue of off-the-job safety. In the last 10 years, workplace injuries are down nearly 24 percent and deaths on U.S. roads and highways have decreased 15 percent. However, injuries occurring in homes and communities have increased 11 percent.

According to McMillan, with 140 million employees and their family members at risk, off-the-job injuries are having an impact on the cost of doing business. "Even with workplace injuries declining, annual employer costs for injuries to workers while off the job and their family members are increasing," he explains. "The costs underscore the need for businesses to assume greater responsibility in extending safety programs to include off-the-job safety for employees and their families."

Increasingly, businesses are beginning to take action. "Whether your employee sustained an injury at work or at home, the fact still remains that that employee is not at work," says Kelly. "If you support safe behavior as the culture at work, it will most likely become part of the culture at home."

As well as having workplace programs, Liberty Mutual has dozens of programs that promote safety at home and in the car, including an exhibit at Epcot. "To move the message of safety beyond the workplace, we teamed with Disney last year to introduce the nation's largest home fire safety exhibit," says Kelly. "*Where's The Fire?* helps families recognize and reduce the likelihood of fires in their homes – it is one way that we can make a difference."

Safety is good business.

It is a solid investment in human capital and brings tangible rewards to the enterprise, its people, industry, customers, and community.

The National Safety Council honors those corporations that embrace safety as a core value. The annual Green Cross for Safety Award recognizes leadership and distinguished service in promoting safety and health for employees, their families, their customers, and the communities in which they operate.

NATIONAL SAFETY COUNCIL®

2005	2004	2003	2002	2001	2000
Liberty Mutual	Chrysler Group of DaimlerChrysler AG	Kenny Construction Company	Ryder System Inc.	Intel Corporation	AK Steel Corporation

THE ROI OF SAFETY

The bottom line on safety: It starts at the top

Q&A

Ed Galante

Senior Vice President Exxon Mobil Corporation

What are your unique safety challenges?

We are committed to taking on the world's toughest energy challenges. We do that safely and in an environmentally responsible manner to meet the needs of a steadily growing world economy. Consider this challenge in terms of how we bring a gallon of gasoline to the consumer. It's possible that the fuel you pump into your car or truck has been transported safely across oceans and land masses, through refineries, pipelines, and terminals, and then been driven by truck to your local service station. At ExxonMobil, we're focused on safety every step of the way.

Has focusing on safety helped your company?

Our corporate wide Operations Integrity Management System sets the highest standards for safety, health and environmental protection. In the past decade, we have reduced injuries by a factor of 10 and lead our industry by most measures of safety performance. Our disciplined, rigorous systems benefit all aspects of our operations and have also led to better productivity and profitability.

In addition to extending its commitment to safety and health into the homes and communities of all their workers, ExxonMobil believes that companies must also help create a safer environment in workplaces and communities throughout the world. To help promote the sharing of best safety practices internationally, ExxonMobil co-sponsors the Robert W. Campbell Award with the National Safety Council. The award honors companies that demonstrate a link between outstanding safety, health and environmental performance with improved productivity and profitability.

ExxonMobil also understands that poor sanitation and disease can have a devastating effect on local economies. The company works with a number of leading international health organizations in the effort to reduce the incidence of preventable diseases. Its efforts in fighting malaria, for example, include funding drug-research programs and providing insecticide-treated bed nets to local villages in the hardest-hit regions of Africa.

> "It has been our experience that a disciplined approach to improving safety performance benefits all aspects of our operations. Our focus on safety has also helped us achieve lower costs, better reliability and higher plant utilization.
>
> ED GALANTE, EXXONMOBIL

The National Safety Council agrees that improving workplace safety and creating a healthy environment is emerging as a significant challenge of the 21st century.

"Safety is not a luxury reserved for developed countries," says McMillan. "As populations and economies continue their rapid growth and development, millions throughout the world are taking on new jobs and new risks like never before. The well-being of workers and their families must be at the forefront, a core business value, in all industries, in every corner of the world."

International safety and health leaders meeting at the World Congress on Safety and Health at Work later this month hope to bridge the international safety gap. This gathering, which is being held in the United States for the first time, will serve as an international forum for bringing greater visibility to the emerging safety and health issues in our increasingly global world.

One topic of discussion is this idea that safety and health programs benefit a company's bottom line. For McMillan, the bottom line is simple:

"The CEOs 'who get it' recognize that a corporate commitment to safety has its costs, but, more important, it pays tremendous dividends in business and human capital."

"Employees who work in a safe environment feel valued and are inclined to want to produce a quality product, increase productivity, and make customers happy," concludes Kelly. "Additionally, safe workplaces are uncluttered and efficient; this combined with a good attitude helps make a business profitable. So there is a clear connection between safety, quality, production, and profitability." ■

For more information on the 17th World Congress on Safety and Health at Work in Orlando, FL, September 18-22, 2005, visit www.safety2005.org

Written by Jill Colford. Design by The Mighty Design Shop.

Campus Confidential

Four top-tier B-schools don't disclose grades. Now that policy is under attack

STUDENTS AT SOME TOP-ranked B-schools have a secret. It's something they can't share even if it means losing a job offer. It's one some have worked hard for and should be proud of, but instead they keep it to themselves. The secret is their grades.

At four of the nation's 10 most elite B-schools—including Harvard, Stanford, and Chicago—students have adopted policies that prohibit them or their schools from disclosing grades to recruiters. The idea is to reduce competitiveness and eliminate the risk associated with taking difficult courses. But critics say the only thing nondisclosure reduces is one of the most important lessons B-schools should teach: accountability.

It's a debate that's flaring up on B-school campuses across the country. And nowhere is it more intense than at University of Pennsylvania's Wharton School, where students, faculty, and administrators have locked horns over a school-initiated proposal that would effectively end a decade of grade secrecy at *BusinessWeek*'s No. 3-ranked B-school. It wouldn't undo disclosure rules but would recognize the top 25% of each class—in effect outing everyone else. It was motivated, says Vice-Dean Anjani Jain in a recent *Wharton Journal* article, by the "disincentivizing effects" of grade nondisclosure, which he says faculty blame for lackluster academic performance and student disengagement.

Just how contentious are things at Wharton? In cross-listed classes, Jain wrote, undergrads outperform MBAs, and the gap is widening. Annual student surveys, he wrote, show that the amount of time students spend on academics has fallen by 22% in just four years. Some of Wharton's best faculty have stopped teaching MBA classes altogether, he added. And those who continue now go to great lengths to keep students in check. Many prohibit late arrivals, talking, and cell phones. Others take attendance, as Harvard Business School does, or give weekly quizzes to make sure students show up for class. "Just like with traffic," says Edward I. George, a Wharton statistics professor. "You need traffic lights to function properly."

RECRUITER TURN-OFF

PROFESSORS AREN'T THE only ones complaining. Recruiters say nondisclosure forces them to resort to interview techniques that test a candidate's quantitative skills. One is the "case interview," which requires job candidates to dissect complex case studies on the spot. In the absence of grades, Andrew Schwedel, who oversees recruiting at Bain & Co.'s San Francisco and Palo Alto (Calif.) offices, asks detailed questions to evaluate a candidate's potential—everything from study group experiences to the courses they took. Richard McNulty, a former recruiter who heads career development at Dartmouth's Tuck School of Business, which discloses grades, says nondisclosure puts good students at a disadvantage and may discourage recruiters from coming to campus. Says McNulty: "I don't think eliminating grades would do anything but create more of a challenge [for recruiters]. Students

Close to the Vest

Students at Chicago, Wharton, Stanford, and Harvard have elected not to reveal grades to recruiters. Here are the two sides of the debate:

STUDENTS:

- Nondisclosure takes the fear out of difficult electives
- Creates a more collegial environment with less competition

FACULTY AND RECRUITERS:

- Students lack incentive to work hard and often don't even come to class
- Without knowing the grades, recruiters are missing a large piece of the competency picture

have to understand these implications."

As it turns out, many do. At No. 1 Northwestern's Kellogg School of Management and other top programs, including those at Cornell and Duke, students have opted to forgo nondisclosure, believing the value of their degrees would suffer. The University of Rochester's Simon Graduate School of Business may even expand grade disclosure. If the proposal is approved, the school will release grades on team projects—an important indicator of whether a student pulls his or her own weight and works well with others. Says Dean Mark Zupan: "A business has a lot of team dynamic to it, and how well someone performs on a team is a valuable piece of information."

Secret grades don't benefit good students

Nondisclosure policies were born during the dot-com boom, when MBAs had a choice of five or six job offers, each with promises of big signing bonuses and bloated benefits packages. At that point, grades didn't matter; MBAs were going to get job offers whether they graduated summa cum laude or at the bottom of their class.

Times have changed, but the policies have not—and they're unlikely to anytime soon, since student support remains strong at schools that have them. Students say they serve an important pedagogical purpose, allowing them freedom to choose difficult electives, such as asset pricing or advanced microeconomics, without fear that a poor grade will kill job prospects. Pass/fail grading, which allows undergrads to take some classes without endangering their grade point averages, serves a similar purpose. "It allows people to explore," says Christopher Morris, director of career management at Wharton. Nondisclosure also fosters a more collaborative culture, supporters say. "If you were to disclose, it would put some people on a more competitive [footing]," says Serhan Secmen, student president of the Wharton Graduate Assn.

For MBAs who aspire to the pinnacle of corporate power, that may not be such a bad thing. Students are unlikely to embrace such a change on their own, but if Wharton is any indication, the pressure to shine a light on grades is growing whether they like it or not. ■

–By Geoff Gloeckler in New York

Power from the Sunbaked Desert

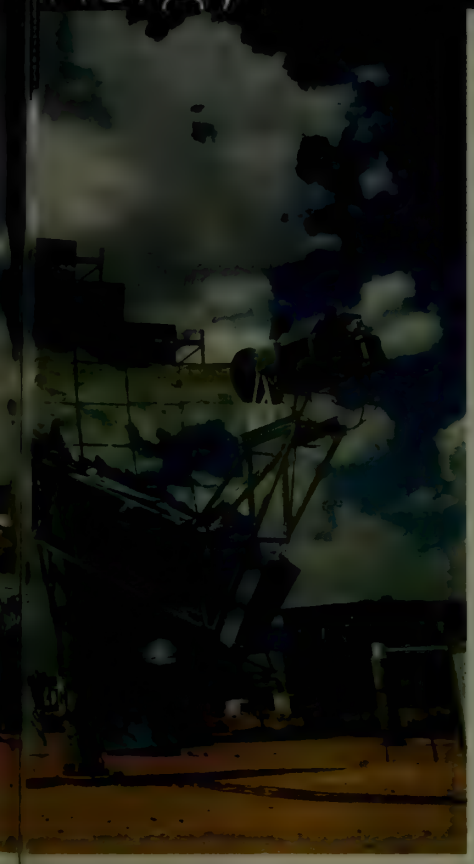
Solar generators may be a hot source of plentiful electricity

BEFORE PRESIDENT George W. Bush signed the federal energy bill into law on Aug. 8, he got a firsthand glimpse of a technology that could transform the deserts of the Southwest. Instead of a sandy wasteland, there would be gleaming farms with thousands of giant dish-shaped mirrors measuring 37 feet in diameter. Each dish would track the sun and focus its heat rays on an oil-barrel-size contraption suspended out in front, harnessing the heat to drive a 25-kilowatt generator.

Plant enough of these solar-dish farms, Bush learned on his tour of Sandia National Laboratories' National Solar Thermal Test Facility near Albuquerque, and they could mightily reduce the r for electric power plants that burn fo fuels and emit carbon dioxide.

MOJAVE MEGAWATTS

THE DAY AFTER THE Presidential t Sandia's vision began to look a lot m real. The supplier of the solar-ther dish generators, Stirling Energy S tems Inc. in Phoenix, won a major co mitment from Southern California E son Inc. (SCE): For 20 years the uti will buy all the electricity that Stirl Energy can generate at a 500-megaw solar energy farm that Stirling will bu in the Mojave Desert near Victorvi Calif. This could be the biggest solar stallation in the world—equal to a ty cal coal-fired plant. And if local pow lines can be upgraded to handle mo



ice, Stirling could enlarge the facility to 0 MW—and SCE would take all of at, too.

Stirling's deal was made possible by veral trends that are pushing alternative ergy into the mainstream. As oil has be-me more expensive, so have natural gas d coal, the primary fuels for power ants. At the same time, concerns about obal warming have prompted lawmak-s—local, state, and now the feds—to un-ash incentives for renewable energy. ind power, solar energy, geothermal, d biomass fuels are all benefiting.

If the dishes do well, Stirling Energy's 500-acre desert farm will usher in new otential for Stirling engines, invented in 16 by Church of Scotland minister obert Stirling. His engine is ideal for een energy because it doesn't burn fuel ternally. Instead, its stons are driven by eating and expanding a servoir of gas, which en cools for the next cy-e. Using the sun's ener-y to heat the gas means ero fuel is burned.

Stirling Energy stands rake in upwards of $90 illion a year once the olar dishes are generat-g 500 MW in 2011. For CE, already the largest urchaser of renewable ergy in the U.S., the ex-a 500 MW will more than double the 354 MW of solar power it tapped in 2004 from nine other solar-thermal operations in the Mojave. It will also add almost 20% to SCE's 2,588 MW of renewable energy sources, including 1,021 MW of wind power. Last year more than 18% of the electricity that the utility delivered to its customers came from renewables.

A colossal dish farm could supply all of America's electricity

Monster dish-shaped "heat antennas" are hardly familiar icons of green power. People tend to associate solar energy with flat, glassy panels that convert photons from sunlight into electric current. But such photovoltaic cells don't produce power as efficiently as Stirling dish generators. Cells typically convert just 10% to 15% of the sun's light—and many cells perform at just half that level. In contrast, Stirling dishes achieve almost 30% in Sandia's six-dish system. "Later this year we'll do even better," declares D. Bruce Osborn, Stirling Energy's new CEO and a longtime solar proponent.

DAYTIME ONLY

WHY HASN'T STIRLING ENERGY'S technology made more of a splash in the power business? "Our dilemma has always been how to get costs down," explains Osborn. The dish assemblies now run $250,000 each. But that's because most have been handcrafted in sporadic lots of one or two units. Building a group of 40 or so would trim the cost to $150,000 each, Osborn estimates. With real mass production, that could drop by 50%.

So when SCE said it wanted to buy more renewable energy, Osborn's outfit proposed the 500 MW project as the means of moving beyond its chicken-or-egg impasse. Producing that much electricity will require 20,000 dishes, built in a steadily increasing flow over several years. "We're ramping up now," says Osborn.

He expects to have 40 dishes in place for a 1 MW facility by the end of next year, followed by 50 MW in 2008 (chart). The electricity will be delivered only when the sun is shining, but that's when the utility's customers place peak demands on electricity. "Our system is a really good match, providing peak power at times of peak load," notes Osborn.

The price per kilowatt-hour (kWh) that SCE will pay is confidential and must be approved by the California Public Utilities Commission. But there's little doubt that the contract will get a thumbs-up, perhaps as soon as next month. One reason: SCE says the price it negotiated is so attractive—"well below the 11.33¢ per kWh" it now pays for peak power—that it won't seek any subsidies from the state.

Subsidies have been a common means of jump-starting solar projects in California and 46 other states. Early this year, Governor Arnold Schwarzenegger unveiled his Million Solar Roofs Initiative, calling for an additional 3,000 MW of solar power by around 2017. If the Million Solar Roofs Initiative passes next month, as expected, homeowners who install solar energy systems will earn a 7.5% state income-tax credit, in addition to other state incentives and the new 30% federal tax credit.

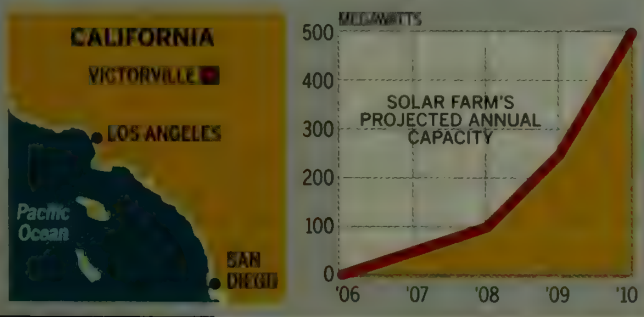
Consumers, of course, are unlikely to plant Stirling Energy's huge 37-foot dishes in their backyards, even if they are the most efficient solar generators around. But the technology dovetails nicely with California's mandate that utilities must derive 20% of their electricity from renewable sources by 2017—and Schwarzenegger would like to boost that goal to 33% by 2020. Osborn says that 11 square miles of dish farms could produce as much electricity as the 2,050 MW from Hoover Dam. "We're already looking at a half-dozen one-square-mile sites in the California desert," he says, "and there's lots and lots more territory there."

Theoretically, 100 square miles of Stirling dishes could replace all the fossil fuels now burned to generate electricity in the entire U.S. What happens in the California desert over the next few years could determine whether thermal solar power can help end the dominance of fossil fuels. ■

–By Otis Port in New York

Solar Is Heating Up

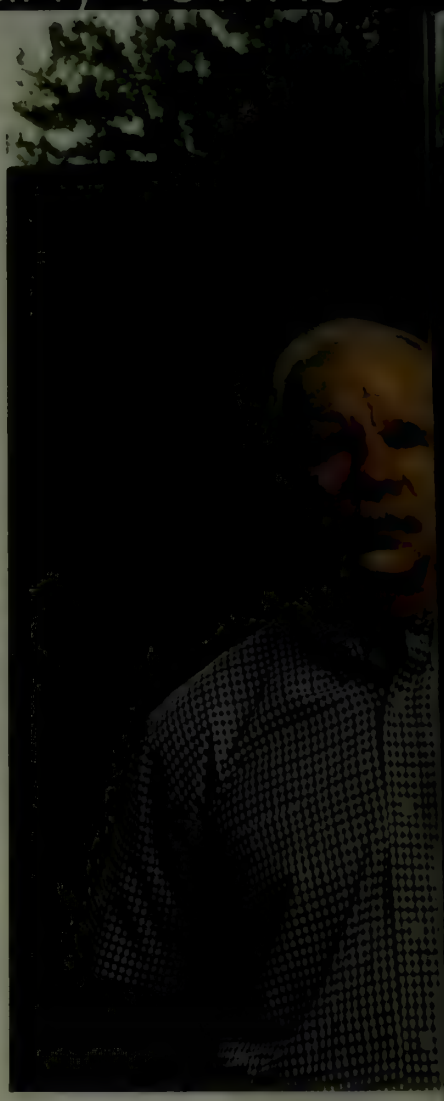
Stirling Energy Systems plans a 500-megawatt solar-thermal plant near Victorville, Calif.



Data: Stirling Energy Systems Inc.

The Empty Arms of Mother Delta

Bankruptcy talk sends shivers through Peachtree City, Georgia



USUALLY, NOTHING TOO crazy happens in Peachtree City, Ga., a pristine little hamlet 35 miles south of Atlanta. Its 36,000 residents cruise around 80 miles of paved paths in their 11,788 town-registered golf carts. Three golf courses, two lakes, and a sprinkling of quaint shopping centers make life in this town a suburban idyll. Peachtree City was ranked the eighth-best place to live in America last month in a CNN/*Money* magazine survey. It boasts the state's No. 1 school system and almost no crime. The front-page news last week: An unruly woman tried to hex patrons of a nearby International House of Pancakes before being arrested.

Behind the placid facade, however, Peachtree City is on edge. Its once-richest patron, Delta Air Lines Inc., which employs 3,530 people in Peachtree City, is sliding toward bankruptcy after $10 billion in losses over the past four years. The city's residents are, almost to a person, preparing for pain. When workers' families are taken into account, about 40% of Peachtree's citizens depend directly on Delta. Already, the "Deltoids," as they are called in town, are taking up second jobs, rethinking long-established retirement plans, encouraging their spouses to go back to work, and in some cases quitting the airline business forever. "If Delta went under, it would be a big ripple," says Mayor Stephen D. Brown.

Peachtree City, in short, is the closest thing in the airline industry to a company town. First carved out of 12,000 acres of pine forest and scrub brush in 1959, the once-remote outpost became a haven for flyboys and their families by the 1970s because of its proximity to Atlanta's Hartsfield-Jackson International Airport. That influx of highly paid pilots and union workers permeated the local economy. The average household income in Peachtree City tops $97,000, according to the Fayette County Development Authority—nearly double the national average. At a median price of $227,000, the town's homes, mostly manicured mansions and tidy bungalows, are worth 36% more than those in Atlanta.

PILOT BAILOUTS

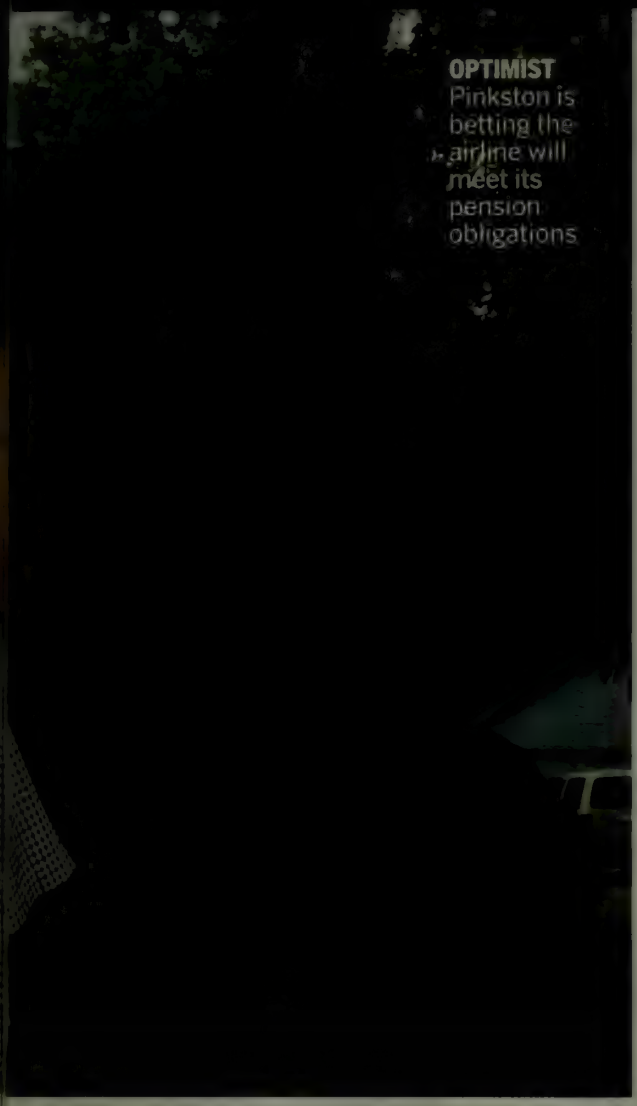
RESIDENTS OF Peachtree City have enjoyed more than just good salaries. A career at Delta also promised adventure, a secure retirement, and lots of free time. Most pilots, for instance, work less than 20 days a month. "The toll [of bankruptcy] will be more emotional than financial," says Bruce Thoman, a retired Delta pilot who has lived in Peachtree City for 31 years. "This was Mother Delta—we had great benefits, great pay. We did well."

> Some 565 pilots have retired early in '05, while Delta still has cash

Now the jet engine that for so long made this place hum is conking out. Consider Delta pilot John Matwick. A 15-year veteran, he flies Boeing 737-800 planes. At 50, he's eligible for early retirement, for which he could get 50% of his pension in a cash payment. On Aug. 1, 145 other nervous pilots jumped at the payout—one reason Delta's $1.7 billion in cash is dwindling fast. In all, some 565 have bailed out since the beginning of the year. But Matwick can't afford it. The financial penalty for cashing out 10 years early would be hu he says—too much for a guy with tv daughters who just graduated from t University of Notre Dame, where tuiti runs $31,450 a year.

Still, sticking it out at Delta is sca too; if Delta were to terminate its pensi plan and hand it over to the governme backed Pension Benefit Guarantee Cor Matwick would take in a measly $26,0 a year. His solution, for now, is to give some leisure hours to moonlight, selli adhesives to high-end woodworki outfits. "It's real depressing," sa Matwick. "Nobody has a good thing say about anything."

Charles M. Pinkston, who joined De at age 30 fresh out of the U.S. Air For faces a different dilemma. A more seni pilot than Matwick, he is loyal to Del and is staying with the company—at hu personal risk. The 57-year-old Pinkston eligible to retire now with a big cash pa out. In fact, so many pilots of his gener tion have retired in the past year th Pinkston has jumped from No. 900 c Delta's seniority list to 72, a plum spot b cause he can practically set his own flig schedule. The reason for the exodus: F



OPTIMIST Pinkston is betting the airline will meet its pension obligations

s want to cash out while Delta can still ford its pension obligations.

Nonetheless, Pinkston, looking tanned d rested in golf shorts and running oes on an idle Thursday afternoon, says 'll wait until yearend before retiring. He ists Delta Chief Executive Gerald Grin-ein's pledge to avoid bankruptcy at all st—and Pinkston will get more money the longer he waits. "We've worked for an honest company," he says. "We don't expect them to stick the knife in and [kill the] pension right away."

Certainly, the once-plush lifestyles of many Delta workers have changed, probably forever. Some pilots are downsizing from big homes to townhouses. Others are leaving the field altogether. Bruce Thoman's son Bret, 33, has traded in his wings for a career in real estate. In January he quit his job as a pilot for ASA, Delta's recently sold regional-airline subsidiary. After two years at ASA, he was making only $29,000 a year, not enough to support his wife and baby daughter. The old pilot lifestyle of flying a couple weeks a month and making big cash is gone. Now, "people are asking: 'What did I get myself into?'" says the younger Thoman, who will make close to $60,000 this year selling houses.

Delta's troubles are reverberating throughout the community. At Plumyumi Day Spa & Boutique, where the six-part fruit peel costs $435, owner Lori Denney has seen business dip as much as 10% in the last month "since they really started talking about bankruptcy." The women of Peachtree City, it seems, are cutting back on their beauty regimes. Denney herself took a buyout from Delta, where she was a reservations manager, after the 2001 terrorist attacks.

At Partners II Pizza, a Peachtree City institution for 28 years, owner Marilyn Royal is anxious despite a sizable line for the Friday $4.75 pizza-and-salad buffet. Sales had risen every month for 12 years straight—until January, she says. That's when Delta pilots gave up $1 billion in wage concessions. Since then sales are down about 5%. Royal worries that if Delta files for bankruptcy, she may have to start cutting back staff hours. "It's scary," she says. "[Delta families] were eating out three or four times per week; now they're doing it one or two."

"AN AMERICAN PROTOTOPIA"

DESPITE THE STRESS in his community, Mayor Brown is unruffled. When Eastern Air Lines shut down in 1991, he recalls, "it sent a shockwave through the city." Home foreclosures rose, and many people moved away. This time around the city is better prepared for whatever happens to Delta. Brown points to a study released this summer by Dr. Ruth Conroy Dalton, a professor at University College London, which dubs Peachtree City "An American Prototopia" because its cart paths prevent sprawl and promote healthy living.

With a typical Southern charm that belies their jitters, local officials say they're confident Peachtree City will get past Delta's potential demise—if only because Atlanta's airport, the world's busiest, is a heavy-duty magnet for any airline eager for a big hub. Brian R. Cardoza, chief executive of the Fayette County Development Authority, observes: "As they say, you can't get to hell without going through Atlanta." ■

–By Brian Grow in Peachtree City, Ga.

A **Bruised** Peach

Bucolic Peachtree City, Ga., the closest thing to a company town in the airline industry, is nervous as its biggest and best-paying employer, Delta, slides toward a possible bankruptcy.

Population 36,000

Percentage supported by Delta 40%

Claim to fame Ranked eighth-best place to live in America in August by *Money* magazine and CNN

Location 35 miles south of Atlanta's Hartsfield-Jackson Airport

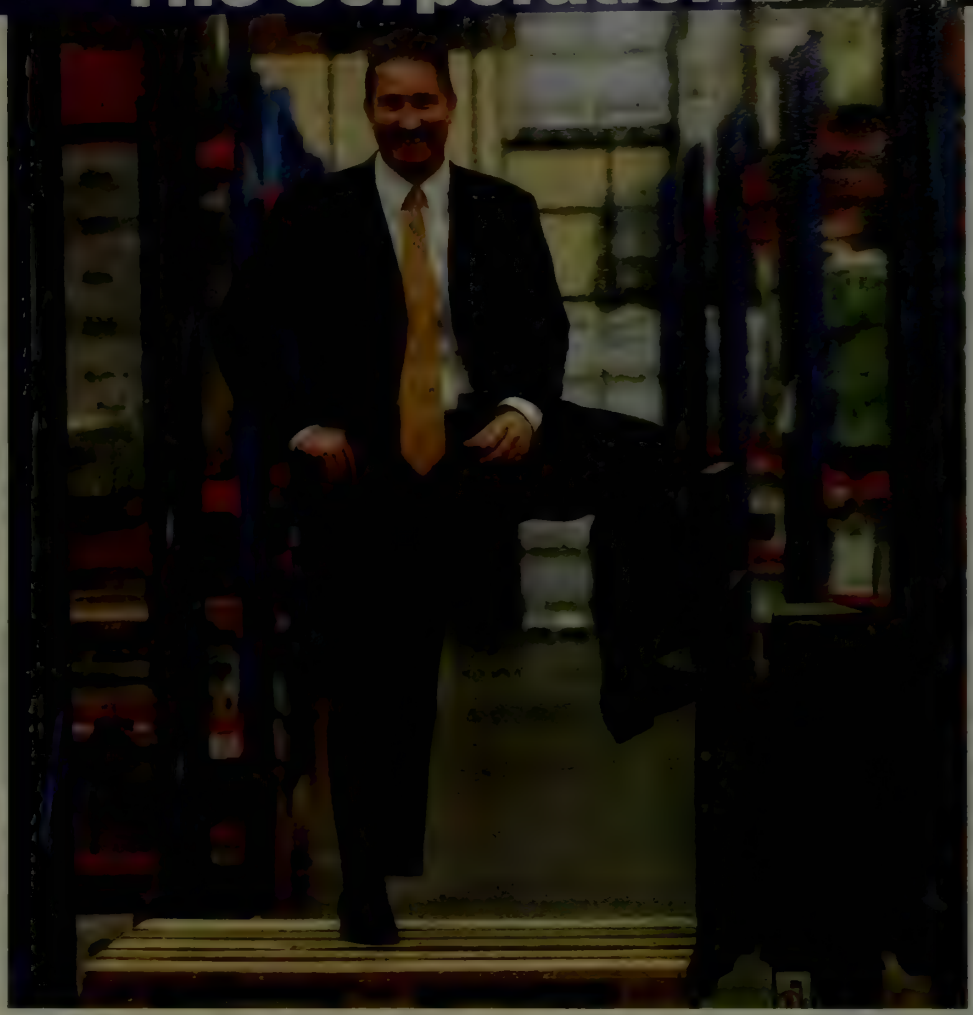
Median home price $227,000 (36% higher than Metro Atlanta)

Average household income $97,000

Miles of golf-cart paths 80

Number of registered golf carts 11,788—one for every three residents

Data: *BusinessWeek*, Fayette County Development Authority, Mayor Stephen D. Brown, *Money* magazine



DEALMAKER Carey's debt from buying vodka makers could produce a hangover

Bottoms Up—And Profits, Too

William Carey built a liquor distributor in Poland. Now he's turning to distilling

AFTER GRADUATING from the University of Florida in 1988, William V. Carey hardly had the look of a future success story. First he tried to make it as a golf pro on the South Africa circuit and other small tours. But as Carey's golfing career floundered, his father told him to get a real job. So Carey decided to go to Poland, where Dad—a Florida cattle rancher—and a partner had put up money to start a small exporting business. "I was going to stay two or three months," Carey recalls with a laugh.

It was a smart stroke. Fifteen years later, Carey, 40, is at the helm of Central European Distribution Corp. (CEDC), one of Poland's leading independent alcohol purveyors. After scooping up 15 small rivals, CEDC became a major player, handling in Poland such well-known brands as Jim Beam bourbon, Johnnie Walker Scotch whisky, and many popular Polish vodkas, including Sobieski.

Carey's knack for dealmaking has propelled CEDC, which is based in Warsaw but maintains U.S. offices in Bala Cynwyd, Pa., t the No. 11 slot o *BusinessWeek*'s an nual list of th 100 fastest-grow ing small companies. In the first half this year sales rose 29%, to $314 millior and profits grew 34%, to $10.2 millior Over the past three years sales hav grown 48% annually, on average, whil net income has jumped 103% a year. I the past four years, CEDC's stock has re turned an intoxicating 1,315%. That ha pushed the value of the 2.8 millio shares owned by Carey and his wife t upwards of $115 million.

Now, Carey is pouring capital into risky new venture: manufacturing. O Aug. 17 he closed a $270 million deal t buy Poland's third-largest vodka distille from French company Rémy Cointrea Group and an investment house. An CEDC recently announced it would spen $312 million for a 61% stake in govern ment-owned Polmos Bialystok, Poland second-largest vodka producer. If th deal closes in September as expecte CEDC will distill about one out of ever three bottles of vodka manufactured i Poland. The deals push Carey into a bus ness in which he has no proven trac record. Still, many investors are bettin he'll deliver. "He hasn't done too mar acquisitions that haven't worked out says James W. Oberweis, president Oberweis Asset Management, which last count held 1.1 million CEDC shares

CARS AND BREWS

CAREY HAS COME a long way since 199 when he arrived in Poland to help run th business his father funded, exporting ca tle. When competition crushed margin the company shut down the cattle bus ness and began importing everythin from used cars to Foster's beer. After rea izing that the lager was what his Polis customers most coveted, Carey and his f ther's partner, fellow American Jeffrey P terson, narrowed the produ line to beer. The company the opened up several of its ow distribution centers and e panded into wine and spirits. 1997, Carey and Peterso decided to raise funds in a initial public offering so they could buy r val distributors.

CEDC was a tough sell. Carey and P terson pounded on the doors of mo than 20 investment banking houses New York. All of them took a pass. "Th didn't know Poland, and the business w small," Carey recalls. "We were ready

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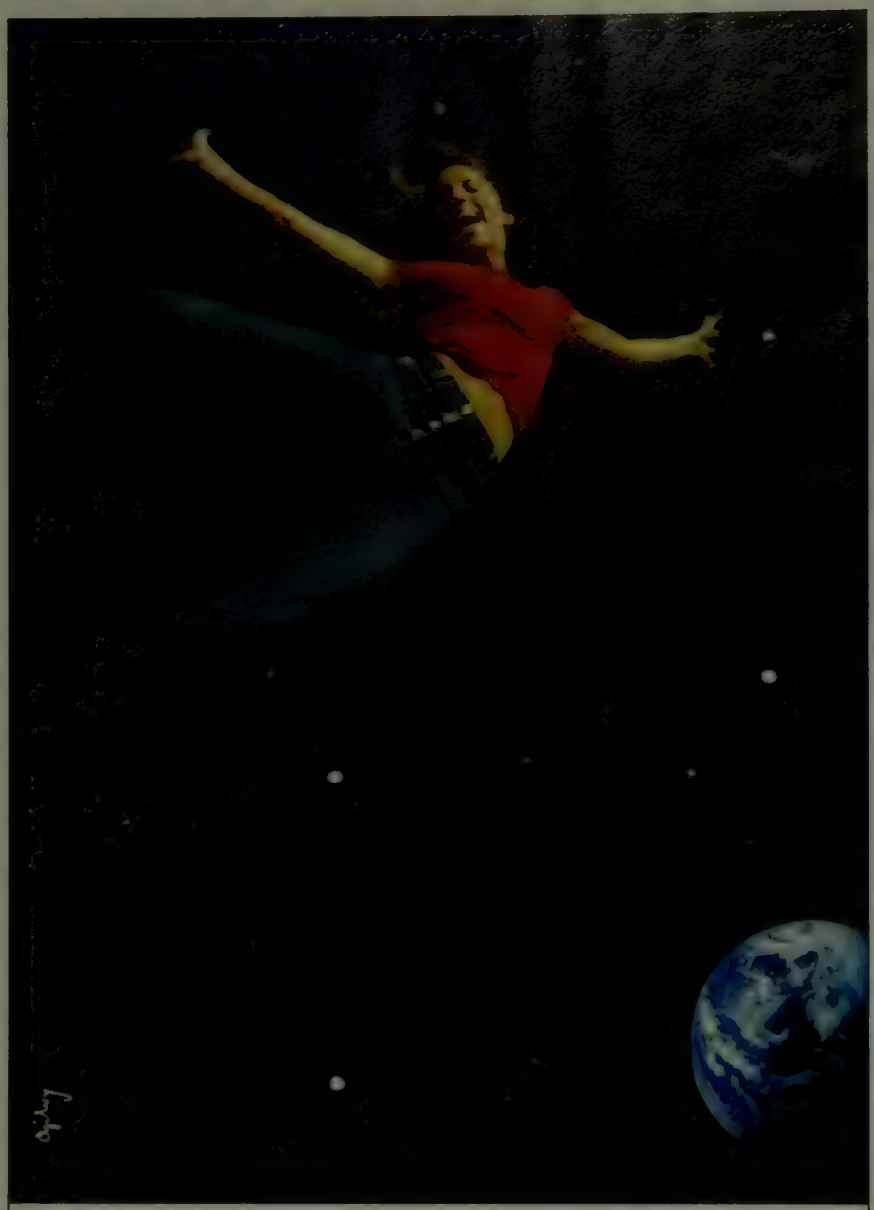

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give up." Then New York investme banking boutique Brean Murray & C took a flier on Carey, helping him rai $10.6 million in an IPO in 1998.

DEBT WEIGHT

THE COMPANY'S acquisitions of Polm Bialystok and Rémy's vodka distilli arm in Poland will make it a powerhou in the Polish liquor market. Furthermo gross profit margins in distilling c climb above 60%—vs. 12% or so in dist bution, estimates First Albany Capit Inc. analyst Randall Scherago. And Car says there are untapped opportunities the businesses he's acquiring. Amo them: exporting Bialystok's Zubrowka flavored vodka.

Still, the deals could produce a fier hangover. CEDC issued $396 milli worth of euro bonds to help finance t acquisitions. That's likely to push its n debt-to-capital ratio from 22% in 20 to 48% this year, estimates Avonda Partners analyst Douglas M. Lane. believes CEDC will throw off $110 m lion in operating cash next year—mo than triple its interest expense. B skeptics say the rising interest, plus t challenges of integrating two acquir companies, may crimp earnings growt "They lost their margin for error warns Walter Ramsley, co-founder money management firm Walrus Par ners, which recently sold its CED shares.

At this stage, Carey is no longer back up by his father, who died in a 1997 c crash. Carey says the success of CEDC w critical to proving himself to his da "Without it, I would have had a diffic time gaining his respect," he says. No he must prove the new venture will be profitable as the old. ■

–By Amy Barrett in Philadelphia, wi Bogdan Turek in Warsaw a Constance Faivre d'Arcier in Pa

HP Says Goodbye To Drama

ive months in, CEO Hurd's no-nonsense pproach is being felt in a big way

T WAS APRIL. R. TODD BRADLEY was sitting on the beach near his San Diego home when his mobile phone rang. A friend was calling to urge him to get in touch with Mark V. Hurd, the newly appointed chief executive of Hewlett-Packard Co. e computer and printer giant was king for someone to run its $25 billion unit. Bradley, fresh off a tough turnound at handheld maker Palm Inc., s a reluctant recruit. "I was ready to on the beach for a while—both litery and figuratively," he says.

Just weeks later, Bradley signed on. e primary reason for his change of art? HP's new boss. Like Bradley, Hurd a straight-talking, number-crunching operations wonk. Hurd seemed intent on ending the high drama that had distracted many at HP during the tenure of his predecessor, Carleton S. "Carly" Fiorina. He wanted to bear down on numbers, spreadsheets, and execution. "Mark seemed like a genuine, focused guy—far more focused on creating value through operational performance than just pitching grand visions," says Bradley.

Five months into his tenure, Hurd's nonsense approach is being felt within HP in a big way. There have been no major press conferences, chock-full of klieg lights. No wrenching changes in strategic direction. In fact, Hurd says he has ruled out, at least for now, the divestitures of the printer or PC businesses that some analysts have called for. Instead of firing up the troops with some grand plan, he's focused on calming things down. "We need to temper the idea that this company has to have some earthshaking event every 15 minutes," Hurd says. "I'm not sure how it got that way—and to be very frank, I really don't care. Our job is to execute."

In a sense, it's the most audacious plan possible. Many experts have come to believe that HP as it is is simply unmanageable. Its product portfolio is unwieldy, ranging from $25 ink cartridges to multimillion-dollar computers, and it's trapped between the more efficient Dell and the more innovative IBM. Many on Wall Street argue that HP needs to narrow its focus, through a major sale or spin-off, to compete more effectively. But not Hurd. He's going to try to run the sprawling, unwieldy organization pretty much the way it is.

NEW BONUS PLAN

THE BIG QUESTION NOW is how. In a series of interviews, Hurd and his top lieutenants provided the first detailed look at the game plan for the new HP. In many ways, it's a lot like the old, pre-Fiorina HP. Hurd's most sweeping initiative is to rebuild the culture of accountability that once made HP one of tech's most consistent performers. In a move yet to be made public, he plans to simplify the companywide bonus system that many found incomprehensible and reward employees based on the performance of their business units and HP overall. He's also tossing out Fiorina's matrix management structure, which muddied responsibilities, to give business heads more control of their units. "The more accountable I can make you, the easier it is for you to show you're a great performer," says Hurd. "The more I use a matrix, the easier I make it to blame someone else."

The changes don't stop there. Hurd is bringing in fresh blood from outside, something Fiorina struggled to do. Besides Bradley, he has recruited Randall D. Mott, the former chief information officer at rival Dell, to be his chief information officer. He moved to trim HP's costs in July by laying off 14,500 workers, from a total workforce of 150,000. And he may have a few surprises in store for HP's analyst conference, scheduled for early December in New York. One of them may be a change in how the company reports its PC results. Bradley is mulling whether HP should revamp its statements to make them more comparable to Dell's, since he contends that would show it is more competitive with Dell than most investors think. "We have to stop letting people believe [Dell] is

"The more accountable I can make you, the easier it is for you to show you're a great performer."

the low-cost provider, because the reality is that we're extraordinarily competitive [with them]," says Bradley.

No doubt, Hurd's toughest calls are ahead of him. He still faces a monumental task. HP's corporate computing business looks incapable of competing against IBM and Dell, and margins are slipping in the printer industry—the source of 85% of HP's profits. But Hurd is benefiting from improved performance that began late in Fiorina's tenure. On Aug. 16, the company reported quarterly results that were much stronger than Wall Street expected. Its stock rose 13% the next day to close at $26.82. Analyst Richard Farmer of Merrill Lynch & Co. thinks Hurd and his team are making progress, but he cautions: "In the long run, they've got strategic challenges and a need to better differentiate themselves."

NUMBERS GUY

ONE OF THE INTERVIEWS with Hurd took place in the boardroom across from his cubicle, at headquarters in Palo Alto. He bounded into the room a minute or two late. At 48, he looks a bit like a younger version of Louis V. Gerstner Jr., the former CEO of IBM. He's a sharp contrast to his predecessor, though. While Fiorina was smooth, polished, and expansive on virtually any topic, Hurd is not. Questions about him or HP's past tend to prompt sighs or smirks. He's plenty confident, but he seems puzzled by the idea of a celebrity CEO. More than anything, he projects the air of someone who just wants to get back to work.

What animates him is talking about the facts and figures of HP. He rattles off numbers from all corners of its businesses, having seemingly memorized nearly every spreadsheet the company produces. One of his first moves after arriving at HP was to work with his team to set the financial targets they think the company should hit by 2008. From there, he and his lieutenants worked backwards and laid out the metrics for each segment of the company. Those calculations helped them arrive at the 14,500 layoff figure and determine that HP can sustain the $3.5 billion-a-year R&D budget they want. With a specific goal three years out, "you can start thinking about the future with a little less emotion and a little more analytics," he says.

FRESH HIRES Ex-Dell CIO Mott, former HP printer exec Lyons, and turnaround veteran Bradley

He uses the same sort of rigorous analysis for personnel decisions. When the company decided it needed a chief marketing officer, Hurd created a "skills map," a list of the skills the ideal candidate would have. He then evaluated all the candidates based on that list. That led to the promotion of Cathy Lyons, a 26-year company veteran. While she hadn't had a marketing position in 11 yea Lyons had a reputation for speaking h mind and for making her numbers head of various units within the print division. Hurd hopes her promotio sends a loud message. "When someo gets a job, it better be clear what they d to get it," he says. "If the organizatio thinks it's because they gave good Powe Point presentations or because they we nice to Hurd when he showed up, you' got a problem. But if it's because she bu a strong team and delivered strong ope ating results, the next person may thin 'Well, that's what I ought to do.'"

That's just one way delivering results being emphasized. Under Fiorina, sale staff were centralized into one group, se arate from business units. That hampere fast decision-making—in some cases, be cause unit chiefs had to lobby for resource from the sales organization, and it ob scured who was responsible for perform ance. As of Nov. 1, however, HP's 10,00 salespeople will all be reassigned back t one of the business units. As a result, th bosses of HP's business units will contro roughly 70% of the costs assoc ated with their operations, u from about 30% under Fiorina

To further motivate HP em ployees, Hurd is also plannin to revamp compensation sys tems. Fiorina installed a com plex bonus plan that left man staffers more confused tha motivated. Payouts were calcu lated from a blizzard of statis tics, including some, such a HP's performance relative t the Standard & Poor's 500 stock index, that were large beyond employees' control. Th new approach will probably ti bonuses directly to the perform ance of the employee's busines unit and to HP overall.

If there are no blockbuste

The New HP: A Lot Like The Old HP

On a number of fronts, Hewlett-Packard's newly minted CEO, Mark Hurd, is steering the company back to its roots as a no-nonsense operator, focused on earnings and management simplicity. His developing game plan:

STRUCTURE Former chief Carly Fiorina centralized the company's operations. Now, Hurd is reversing many of those moves. Among other things, he's breaking up the centralized salesforce and assigning salespeople to each business unit. Those units now control over 70% of their own budget expenses, up from 30% under Fiorina.

COMPENSATION Employees have long griped about a bonus plan O.K.'d by Fiorina that most found incomprehensible. Look for Hurd to put through a simpler plan, with employees' bonuses tied to the performance of their businesses as well as that of HP.

MARKETING The company is shifting away from glitzy image ads to spots that push specific products.

LEADERSHIP Fiorina recruited few top executives from the outside during her tenure. Now, HP's 11-member executive council includes four newcomers, including Hurd. All four are proven operations whizzes, such as former Palm Inc. CEO Todd Bradley and former HP printer-cartridge chief Kathy Lyons.

WHEN THE INFORMATION NEVER STOPS, NOTHING CAN STOP YOUR BUSINESS.

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changes coming, Hurd & Co. are planning a plenty of smaller surprises. For instance, Mott, a bona fide superstar who helped turn Wal-Mart Stores Inc. into a merchandising powerhouse before going to Dell, has big plans for HP's information systems effort. He thinks there's a golden opportunity for HP to cut costs, since it hasn't upgraded its tech systems in years as it focused on integrating its systems with Compaq's. More important, Mott plans to build sophisticated data-mining capabilities, similar to those at Dell. That will let Hurd see the critical data from around the company almost instantaneously. "He and I have always talked about what was possible if you could make decisions based on facts, rather than guesses," says Mott.

RETAILER REPAIRS

THAT PRAGMATISM is making itself felt in many other ways as well. Take distribution. During her first few years, Fiorina pushed hard to sell products direct, just like Dell. That frayed relations with retailers and other resellers that move about 60% of HP's products. Now, Hurd is working fast to repair those partnerships and take a more refined approach. While the company will still sell directly to large corporations and some consumers, it wants to build stronger relationships with the resellers that work with small and midsize companies. The goal: to reward resellers that offer more profitable bundles of HP products, rather than just stand-alone products. "Mark is totally evidence-based," says Steven A. Raymund, CEO of industry giant Tech Data Corp. "It's clear he wants to do more for us, if we do more for him."

Add it all up, and HP's new management team is off to an impressive start in reviving the once-great company. Which has created a long-forgotten problem for HP: It suddenly faces some pretty high expectations. The company's stock has risen about 35%, to $27, since Hurd was tapped as chief executive.

But Hurd isn't about to get distracted from the massive task at hand. With his spreadsheets and his targets for 2008, he's eager to roll up his sleeves and put an end to the drama of the past few years. "Bill [Hewlett] and Dave [Packard] were that way," recalls Dennis Cain, a 32-year HP veteran who recently left the company to join contract manufacturer Solectron Corp. "Don't talk about what you're going to do. Just do it, and then let other people talk about it." ■

–By Peter Burrows in Palo Alto, Calif.

A Poker Game for Samsung's Chips

Austin and Albany are playing a high-stake hand—with a $3.5 billion plant on the tabl

IT'S LIKE A HIGH-STAKES GAME of Texas Hold 'Em. On one side of the poker table are the guns from Austin, Tex.; on the other the sharks from Albany, N.Y. The stakes are huge: The two sides are squaring off over a new, $3.5 billion Samsung semiconductor plant, which will come with about 900 high-paying jobs and a secure spot in the high-tech industry's future.

Never mind that Korea's Samsung hasn't even definitively decided to build the plant. Or that the company might simply add another chip-fabricating facility to its 14 fabs near headquarters in Seoul. Or that Samsung's execs may figure China is the best site—since it wou neatly position Samsung in the middle the world's fastest-growing electron hub. While Austin and Albany know t odds could turn against them, they're f riously bidding up the financial ince tives designed to attract the Koreans.

Austin, the site of Samsung's only e isting U.S. fab, is putting together package of $225 million in tax relief a other goodies, spread over 20 years. T City of Austin and Travis County just v ed to ante up some $100 million. Sta and school district officials are expect to come up with the rest of the incentiv by the end of September. This is b money in a state that traditionally has

ıd to spend much to attract businesses ıd one where a lot of folks consider such centives unseemly corporate welfare at time when state finances are tight. The epublican-controlled state government n't even come up with the money or a an for financing the state's strapped hools—despite two special legislative ssions this year.

But there is surprisingly little opposi-on so far to spending what it takes to get ımsung. Austin knows that despite a re-nt investment of $500 million, Sam-ıng's existing Austin plant, which em-oys more than 900, is middle-aged with a life expectancy of only a decade. ıst as important, Austin sorely needs to gain some of the Big Mo in tech that it ıd in the 1990s. Its early success in emiconductors helped attract hundreds f other tech ventures and, along with PC ggernaut Dell Inc.'s phenomenal suc-ess, made Austin one of the country's conomic hot spots, with 5% annual em-oyment gains throughout the decade.

But those were the good old days, be-ore the tech meltdown. Since then, ustin has seen its number of fabs drop om 13 to 8—and its chip-industry work-orce shrink 38%, to 14,900. Adding to e pain, Austin finds itself in a whole ew ball game, where the competition to ure high-tech jobs has become more lobal and intense than ever before. One wake-up call came in late 2003, when Advanced Micro Devices Inc., thought to be a loyal Austin chipmaker, chose Dresden, Germany, for its new fab, after being lured with $1 billion in incentives.

DEEP POCKETS

THE RIVAL ROILING Central Texas comes from a bit closer to home. It's George E. Pataki, New York's governor. He's taking direct aim at Austin in his effort to establish Albany, the state capital about 150 miles north of New York City, as a prime venue for technology development. And in recent years he has created powerful momentum. His coup came in 2002, when International Sematech (for semiconductor manufacturing technology), a research and development consortium made up of a dozen giants including IBM, Intel, and Samsung, chose the University at Albany as home for a $400 million research center.

Sematech has made its home in Austin since 1988 and has been a key building block for tech development. Pataki noted in his announcement how the original Sematech helped the Austin area double its population in little more than a decade, attracting 200 chip-related companies and 450 software-development outfits. Kicking a little dust in Austin's face, Pataki also said he was hiring Angelos Angelou, an Austin consultant who had been a driving force in recruiting high-tech companies to Texas.

Now, with Samsung's next plant in the balance, Austin is concerned that it is up against a New York with deep pockets and decent momentum. The Pataki forces, after committing more than $200 million to Sematech, have now prepared a package with Samsung's name on it totaling an estimated $300 million.

Both cities are fighting for 900 jobs—and their high-tech future

Winning the Samsung plant may not be life or death for Austin's high-tech future, but it's mighty close. The plant will use the latest semiconductor technology to carve chips out of wafers 300 millimeters in diameter, up from 200mm for the previous generation. The bigger wafers accommodate at least twice as many chips for essentially the same cost as the smaller wafers. That extra efficiency means 300mm fabs can quickly render the older plants obsolete.

Will Wynn, the mayor of Austin, is determined to secure a prime place for his city in this new world. He calls winning the Samsung deal "crucial" and not only because of the jobs at the facility itself. Such a plant also spawns supporting businesses in software, chip equipment, and so forth, and helps workers develop tech-related skills. "Austin was extremely successful in first-generation technology," says Wynn. "The question now is: Are we going to be successful in the second generation?"

Wynn has helped rally support for the Austin financial package and has led an unrelenting sales effort. He honored Samsung's recent investment in its existing plant by presenting H.K. Park, president of Samsung Austin, with an Epiphone guitar, along with a proclamation that "Austin and Samsung have truly made great music together." Texas Governor Rick Perry visited Samsung's Austin plant this year to sign into being a $200 million Emerging Technology Fund, for financing Texas industry.

Government incentives to attract businesses have long been controversial. But in the chip industry, states seem to have little choice if they want to be contenders. The Semiconductor Industry Assn. (SIA) argues that tax breaks and other financial incentives are the primary reasons that two-thirds of all new chip capacity is being built in Asia, particularly in China. In a study of the issue, the SIA says that the costs of a fab over 10 years are roughly $1 billion more in the U.S. than in Asia. About 90% of that difference comes from tax benefits and capital grants, while labor costs account for a mere 10%. That's why the SIA encourages the kind of assistance Texas and New York are offering and is pushing for federal measures, such as making the R&D tax credit permanent.

For now, Samsung isn't showing its cards. It acknowledges that part of the $24 billion committed to future tech investment could go to build a 300mm fab, which would be its fifth, and that it is looking at lots of sites. Local Samsung officials say they have been happy with Austin and that the locale has pluses such as qualified labor and plenty of the electricity and water that are needed for chip fabrication—but that a decision will be based on many factors. No one knows whether Austin, Albany, Korea, China, or a wild card will win the prize. Still, there's already one sure winner in this game: Samsung. Texas Hold 'Em is much more fun when you know you'll grab the pot. ■

–By Mark Morrison in Austin, Tex.

A Ray of Hope For the Fee Fighters

Lawsuits arguing that funds overcharge retail investors have cleared a big hurdle

IN THE WAKE OF THE MUTUAL fund scandals, New York Attorney General Eliot Spitzer in 2004 forced nine mutual fund firms to cut the fees they charged to investors for the next five years. Now, in a rash of lawsuits against at least 11 of the industry's top firms, individual investors aim to repeat that feat—and obtain compensation for alleged past overcharging.

The stakes are huge. Spitzer alleged that small investors are paying $10 billion a year too much in management fees—the charges for researching, picking, and trading stocks and bonds. But the hurdles are considerable, too: For decades courts have given the $7 trillion fund industry a pass on setting fees by finding that charges were not "excessive," the standard set by precedent. In fact, no investor has ever persuaded a judge to force a fund to roll back its fees. Most suits have been dismissed before getting to trial because fund companies successfully argued that their fees were in line with those of competitors.

In recent months, however, federal judges have turned down motions to dismiss cases against Franklin Resources Inc., the largest publicly traded fund company; Ameriprise Financial, the fund unit being spun from American Express; Putnam, owned by Marsh & McLennan Cos.; and ING Investment Management Americas, a unit of ING Group. The suits are now headed to trial, with the first scheduled for next spring. "Suddenly, you see a few cases where the courts are starting to send a shiver down the spine of every fund [company]," says Tamar Frankel, a Boston University School of Law professor who has followed the industry for almost 40 years. Six of the companies being sued—Fidelity Investments, Ameriprise, Putnam, Janus Capital Group, ING, and American Century Investments—say the suits are without merit and that they will vigorously fight them. "Management fees at Fidelity are well within the range of fair and reasonable," says spokesman Vin Loporchio. The other five—Franklin; Federated Investors; MFS Investment Management, a unit of Sun Life Financial; AIM Management Group, a unit of Amvescap, and Waddell & Reed Financial—declined to comment.

The new litigants are apparently making headway because they have adopted a different legal strategy. The suits argue that fund companies routinely charge retail investors twice as much—or more—as big pension funds and other institutional clients for managing similar funds. The approach is based on a 2003 study by University of South Carolina Law School professor John Freeman and Florida State University finance professor Stewart Brown. They found that the management fee levied by the average retail stock fund was 0.56% of assets, vs. 0.28% for a similar institutional fund. It was the study Spitzer used to p details of their fees fro

Sticking It t the Little G

Retail investors in sto mutual funds fork ov management fees th be two or more times institutional clients p for nearly identical fu Three examples:

ance Capital Management, Put-
n, Bank of America, and six other
ns, and then force cuts of as much
20%.

W LINE OF DEFENSE

/ESTORS MIGHT ALSO be helped by
nanged legal climate in which courts
y be more skeptical of the industry's
ionale for its fees, says Frankel. "The
ustry is concerned [about these law-
ts] because of all the enforcement ac-
ns and investigations," says Thomas
Harman, a former Securities & Ex-
nge Commission attorney who rep-
ents fund companies and is a partner
he Washington (D.C.) office of law
n Morgan, Lewis & Bockius. "There's
int on the industry."

Of course, selling and running a mu-
l fund with thousands or even mil-
ns of individual customers is much
re expensive than serving a single
nsion fund. To recoup these extra
ts, though, fund companies typically
rge separate marketing and adminis-
tive fees.

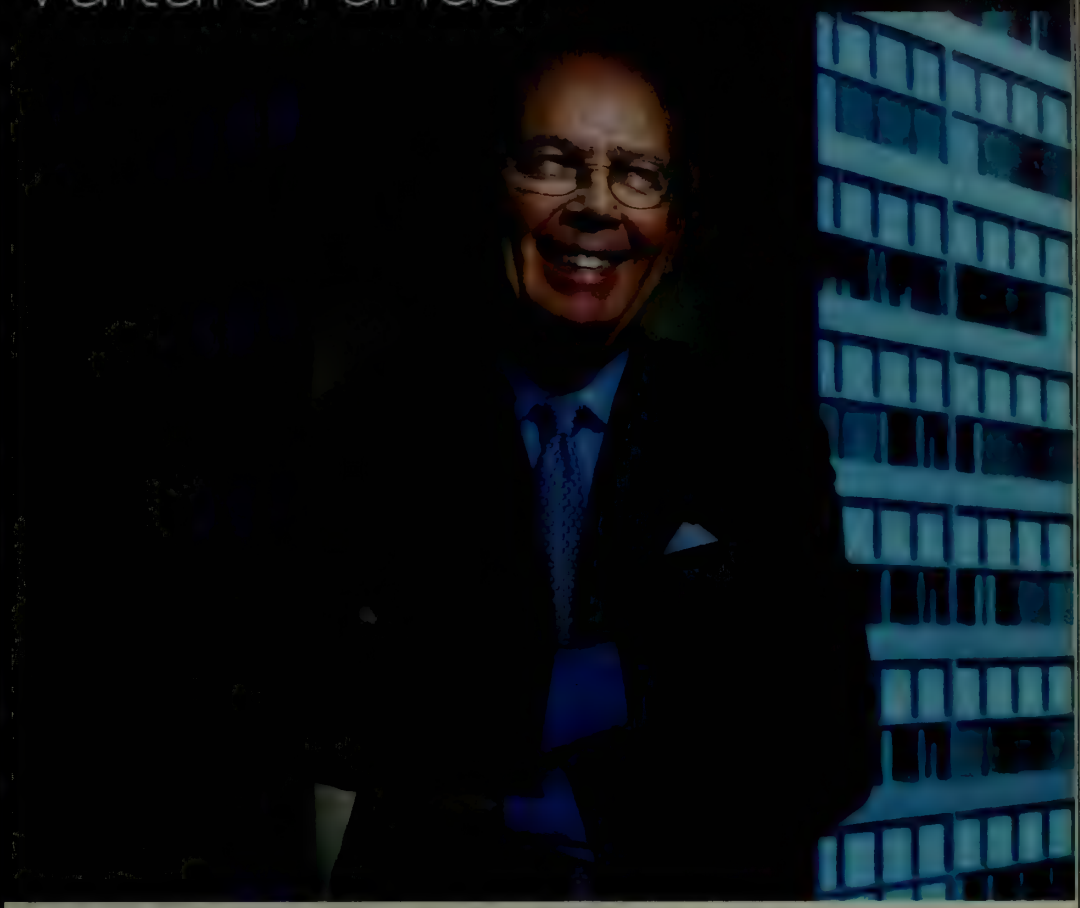
Fund companies are being forced to
pare a new line of defense. They say
y will show that management fees
d by retail investors cover a much
ater array of services than those paid
institutions. "The management fee is
t the same in both cases," says Brian
id, chief economist for the Invest-
nt Company Institute, the fund in-
stry's trade group. He notes that each
tual fund for retail investors is actu-
y a separate entity and must pay for a
ard of directors. It's also subject to ac-
nting and legal requirements that
n't apply to pension accounts, he says.

It's still early days for these suits—
e fund companies will get another
ance to have them dismissed before
als begin. But if the cases end up in
nt of juries, many fund executives
y feel a lot more than just a shiver
wn their spines. ■

–By Aaron Pressman in Boston

	PERCENT OF ASSETS
c Value Fund (A shares)	0.66%
o value account for of Alaska	0.17%
n Foreign Fund (A shares)	0.63-0.56%
nal equity portfolio for the State retirement system	0.35%
Magellan Fund	0.43%
usetts' Pension Investment ent Board	0.0%

Data: Court documents, fund prospectuses



Bring On the Battered Debt

Wilbur Ross and other investors are betting on a wave of bankruptcies

LOTS OF SMART PEOPLE think the junk-bond boom of the past few years is about to end with a series of defaults, and they're lining up to cash in. Billionaire Wilbur L. Ross Jr. and other storied vultures are quickly raising giant funds to invest in troubled companies, while heavyweight investors such as the California Public Employees' Retirement System are rushing to invest. "When the distressed business is good, we can get about net 20% returns," says Panda Hershey, portfolio manager at CalPERS.

The signs of a coming buyer's market for distressed debt seem abundant. The percentage of new junk bonds rated B-or lower—just four notches above the bottom of the heap—reached a 20-year high of 34.2% in 2004, according to Merrill Lynch & Co. Historically such surges are followed by a rising number of defaults within two or three years.

And many of these issues came complete with red flags: Companies sold the bonds just to pay big dividends or cover old debt, or the bonds carry floating rates that will rise as interest rates do. Fund managers also are eyeing the huge growth in second-lien loans—in which lenders are second in line for repayment in a bankruptcy—and in loans used to finance leveraged buyouts.

The default rate is still low, but if it starts accelerating, the new funds are making sure they're ready. They'll de-

ploy their money to buy up a flood of junk bonds gone bad—often for pennies on the dollar. The bet is that if the bonds default, that will allow the funds to gain control of a viable business once it emerges from Chapter 11.

NEW PLAYERS

INVESTORS LIKE THE bet. They've poured some $6.3 billion into these funds over the past 12 months. When Ross's firm, New York-based WL Ross & Co., set out to raise a new fund this past spring, it aimed to pull in only $500 million. But on June 30 the firm capped its fund at $1.1 billion. "We turned away about as much as we took in," says Ross. CalPERS, the nation's largest public pension fund, put $50 million into Ross's fund and $75 million into another $1 billion fund raised by New York's Avenue Capital Group. CalPERS, in fact, advised Avenue to set the fund up. "The reason we raised money now is that we think the cycle will start over the next six to 12 months," says Marc Lasry, Avenue's founder and managing partner.

At the same time, new players are jumping in. Distressed-debt managers at Credit Suisse First Boston, Deutsche Bank, and elsewhere have recently left to raise their own funds. "Guys who are starting funds now are saying, 'This is a low point for defaults, but let's get our buying power assembled,'" says Martin Fridson, CEO at high-yield bond researcher FridsonVision.

Opportunity is already at hand for distressed-debt mavens. "One sector we've gotten quite interested in is auto parts," Ross says. Along with other firms, WL Ross has bought most of the $750 million in bank debt owed by Troy (Mich.) car-parts maker Collins & Aikman Corp., which filed Chapter 11 in May. At least 10 other auto-parts companies have entered bankruptcy this year. Several others are teetering on the brink. Ross could try to roll up the best of the bunch and sell them at a profit, as he has done with steel, textile, and coal companies.

Until default rates rise, it's not clear which other sectors are ripe for Ross and other vultures. "We keep looking at airlines but haven't figured out the right way to play a constructive role," explains Ross.

Auto-parts makers typify recent junk-bond frothiness. Over the past two years several issued bonds that added no cash to their coffers; the proceeds instead went to refinance existing debt or stave off defaults. Goodyear Tire & Rubber Co., for example, last year sold $650 million in junk bonds to pay off a $583 million bank loan and to reduce other looming obligations. "We feel very committed that we are going to meet our obligations," says Goodyear spokeswoman Tricia C. Ingraham.

Private equity firms have contributed to the glut of debt with a controversial stratagem. They recover chunks of their equity investment fast by getting companies they own to issue junk bonds and then pay out dividends from the proceeds. In December, 13 months after acquiring Warner Music Group for $2.6 billion, private equity firms Thomas H. Lee Partners, Bain Capital, and Providence Equity Partners had the company sell $700 million in junk bonds to pay a dividend. When the company went public in May, investors looked askance at the dividend deal, forcing Warner to lower its offering price to $17, from a range of $22 to $24 a share.

Rising interest rates also could stretch some companies to the breaking point. To entice investors, junk-bond issuers last year began offering floating-rate notes, exposing themselves to the same kind of payment shock that homeowners with adjustable-rate mortgages fear. Energy company Calpine Corp. last year issued $680 million of seven-year floating-rate notes. With four times more debt than equi on its balance she Calpine is still highly leve aged, although it is getti its finances under contr selling assets and cutti debt by $3 billion to $15 b lion this year. "We feel pre ty comfortable," said Ch Financial Officer Robe Kelly in July.

The explosion of secon lien lending has created a other opportunity for the vultures. "Th is the next big distressed market," sa Mark K. Holdsworth, managing partn at Tennenbaum Capital Partners, whi recently closed a $1 billion fund. Oft used as rescue financing for compani second-lien loans typically have the san rights and covenants as bank loans, e cept that they don't get repaid first. Ne issues of such loans grew last year to record $12 billion, up from $3.3 billion 2003, according to credit-rating agen Standard & Poor's.

LEVERAGED UP

LOANS USED TO finance leveraged bu outs also are on the shopping lists of di tressed-debt investors. Last year su loans to companies rated below inves ment grade surpassed $50 billion, t highest level since the 1980s, according researcher Loan Pricing Corp. As de sizes have increased, banks have grov more lenient about the amount of leve age they allow companies to use.

Reaping big returns from bad debt not exactly a cinch. Cheap bonds m only get cheaper, causing a fund to lo money. And funds may miss the jackpot they get outmaneuvered in bankrupt court by other creditors and fail to w control of the company.

Not everyone thinks a wave of bad de is coming. For now companies are st servicing their bonds: The junk-bond d fault rate was only 1.7% at the end of Ju barely above its eight-year low. "We do think the default rate will rise much, a not to double-digit levels over the ne term," says M. Christopher Garma global high-yield strategist at Merr Lynch. S&P predicts it will creep up on to 2.5% by next April.

Nevertheless, distressed-debt i vestors are getting ready for the delug "We're not sure when it's going to crac but it certainly has to," says CalPER Hershey. Their preparations may be t best indicator of a debt market head for a correction. ■

–By Justin Hibbard in San Mateo, Ca

The big prize for funds: Winning control of bankrupt companies

Sensing Trouble

Distressed-debt funds have been raising big bucks on the possibility of a sharp rise in corporate bond defaults

AMOUNT RAISED	
Matlin Patterson Global Advisers	$1.6 Billion
Oaktree Capital	1.2 Billion
WL Ross	1.1 Billion
Avenue Capital	1.0 Billion*
Blackstone	500 Million*
Carlyle	400 Million*

*Planned. Data: Private Equity Intelligence

Speed Bumps For Dealmakers

roposed rule changes may force buyers bare more detail—and take more lumps

CORPORATE HONCHOS have lots of reasons to pass on acquisitions, from clashing cultures to adverse Wall Street reaction to high costs. Soon they may have a new one: posed accounting rules that could rt their results, make earnings more atile, and turn a spotlight on high deal s charged by investment bankers and yers. "These are big changes," says leen Cunningham, president and CEO Financial Executives International, an sociation of corporate finance officers d controllers.

Cunningham and other executives n't happy about many of the changes, ich have been more than four years in making. One proposal would radical- alter how companies account for the ue of research and development at a npany they're buying. Another might courage the common practice of buy- promising extra payments to sellers pending on how well the acquisition rforms. Significant as they are, the anges are unlikely to stop M&A in its cks. Deals will need more preparation d become more complicated to execute, s Tomer Regev, an investment banker Morgan Stanley, but people "will learn live with the accounting."

The Financial Accounting Standards ard, which has posted its proposals for blic comment, seems to agree. It seems on an unswerving course now, regard- s of whether the changes make earnings k worse or better. "We're trying to cre- high-quality information," says G. chael Crooch, the FASB member over- ing the effort. The Norwalk (Conn.)- sed board, which usually gets its way as U.S. keeper of generally accepted ac- nting principles, says it expects the rules to take effect at the end of next year.

Pain in the Bottom Line

Proposed changes in accounting rules for acquisitions would dent buyers' reported profits because they would have to:

EXPENSE investment banking fees and other deal costs, instead of booking them as an asset, as they do now

TAKE CHARGES for plant closures and other restructuring costs, instead of counting them in the deal price

AMORTIZE R&D they acquire as they sell products it generates, instead of writing it off from the get-go

Data: Bear, Stearns & Co., The Analyst's Accounting Observer, Financial Accounting Standards Board

If adopted, the decision would be a milestone in the drive for consistent accounting around the world, making it easier for investors to compare companies based in various countries. That's because these are the first standards proposed simultaneously by FASB and the London-based International Accounting Standards Board, whose code has been adopted in Europe and elsewhere.

The new rules put great emphasis on fair value accounting. Under this, assets and liabilities are reported at their estimated current values rather than their historical cost. As the estimates change, companies report the ups and downs as profits and losses, even though no cash changes hands. For example, some buyers would have to estimate purchase prices based on the probability that an acquisition will do well and thus trigger a bonus payment to the seller. The FEI's Cunningham frets that earnings volatility from updating estimates could discourage buyers from offering performance incentives. "It would be a shame to see some of that go away," she says. Worse, she fears that investors could become suspicious of management. "It is going to look like companies are managing their earnings even though they are following the rules," she says.

GOLD RUSH?

THE NEW RULES also could depress earnings for months, even years, if the purchased company has a lot of research and development on the verge of yielding saleable products—often the bulk of what buyers of biotech companies acquire. The buying company would have to subtract the value of such R&D from earnings as its products generate revenue. Current rules allow buyers to write off this R&D all at once when they close on a deal, potentially goosing profit margins for years. Last year, Eli Lilly & Co. wrote off such R&D valued at $362 million, or 82% of what it paid for Applied Molecular Evolution. Accounting analyst Chris Senyek of Bear, Stearns & Co. predicts pharma companies will rush to buy biotech outfits before the rule takes effect.

Accounting for restructuring costs would also change significantly. Now they are estimated up front and rolled into the acquisition price. FASB's proposals would end that free pass by making companies expense restructuring costs as they are incurred. "It is a drag on earnings," says Raymond J. Beier, a U.S. partner at PricewaterhouseCoopers.

Investment bankers may suffer some

collateral damage. Buyers would no longer be able to bury their fees in the price of what they're buying. Instead, they would have to subtract the fees from earnings when they fall due. The hit in a single quarter could be substantial. If that had been the case when Harrah's Entertainment Inc. bought Caesars Entertainment Inc. in June, its second quarter pretax income would have been slashed by $52 million, or more than a third. One result could be more pressure on bankers to cut deal fees. No doubt the bankers will say investors should ignore the expense because it isn't recurring.

Another proposal—that buyers should book purchases when they close deals instead of when they announce them—seems innocuous but will add uncertainty to dealmaking. Buyers, particularly those paying with stock, will be less su of how much they'll have to report payi for a takeover. As a result, says Morga Stanley's Regev, more deals will inclu "collars" to limit how much purcha prices can change before closing.

Dealmaking may be less fun in the f ture. But investors should get a mu clearer view of what it's costing them.

–By David Henry in New Yo

OfficeTiger Roams Toward an IPO

Its MortgageRamp deal will make it a bigger pure play in outsourcing

IN 1999, AT THE HEIGHT OF the dot-com boom, Randolph Altschuler's and Joseph Sigelman's co-workers wondered if the two young men had lost their minds. The best friends—they met during their freshman year at Princeton University—ditched their Wall Street jobs and combined annual income of $500,000 to found a startup. But not in Silicon Valley. Instead, they went to India, launching a company to provide back office services for U.S. financial giants. They were among the first to bet that well-educated workers in India could do a better job for less money preparing PowerPoint presentations and other grunt work than junior investment bankers in New York. They called the firm OfficeTiger, after the Princeton mascot, and never looked back.

ALTSCHULER AND SIGELMAN Fresh from Indian exploits

Today, after years of round-the-clock work, the two 34-year old co-CEOs don't look so crazy. Nor do they regret leaving their old jobs—Altschuler was at Blackstone Group Inc., and Sigelman was with Goldman, Sachs & Co. Since they blazed a passage to India, hundreds of outsourcing firms have set up shop in Bangalore, Bombay, and elsewhere. But few have been as successful as New York-based OfficeTiger. It has doubled sales every year since its founding and is on track to hit $100 million this year. Execs say the 3,000-employee company has been profitable for the past three years.

Now, OfficeTiger is set to pounce again. In its first acquisition of a U.S. company, it's gobbling up MortgageRamp Inc., a privately held, Atlanta-based financial outsourcer, *BusinessWeek* has learned. The deal, valued at $25 million to $30 million, could be announced as early as Sept. 5. The purchase provides OfficeTiger a shot at offering support services to commercial real estate lenders, services that some analysts say are poised to begin shifting overseas.

More significantly, it puts Altschul and Sigelman firmly on the road to an in tial public offering. While they've sh down the prospect of going public in t past, they now say they're headed that d rection. The MortgageRamp deal w boost their sales about 35% and ma them a more attractive, pure-play ou sourcing firm. "This brings us much clo er to doing an IPO," says Sigelman.

Although OfficeTiger is a leader, it h scores of Indian rivals, including WN Global Services and ICICI OneSource Lt Over the next year or two, bankers expe a shakeout to roil the industry. "The iss for these companies will be scale," sa Edward Males, ma aging director investment bank Je feries Broadview.

Sigelman a Altschuler are betti the MortgageRan deal gives them t kind of specializ knowledge that w keep them ahead the pack. The comp ny will train hundre of Indian workers help MortgageRan process commerc property loans, i cluding exotic instr ments, such as mo gage-backed securities. MortgageRan CEO Ken N. Beyer, who will remain C of OfficeTiger's real estate division, sa the industry's financial due diligence i creasingly will be done overseas. "V can't keep up with the demand," he sa

If Altschuler and Sigelman have prov anything in their six years in India, i that they know how to tap the natio wellspring of talent. One of Sigelman's vorite recruiting spots is the Taj Co nemara, a hotel in Chennai where he h spent much of the last five years. "I poa from the reception desk," he says. Sou crazy? It makes perfect sense now. ■

–By Spencer E. Ante in New Yo

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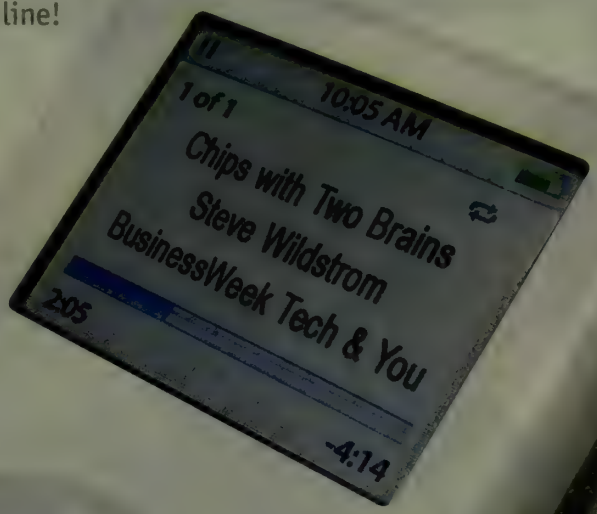

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Dodging That #¢+! Traffic

GPS systems can steer you around jam-ups, but ease of use varies widely BY LARRY ARMSTRONG

I SPENT THE DOG DAYS OF gust playing in traffic. Litera was behind the wheel, searcl for enough traffic in norm gridlocked Los Angeles to pr out a half-dozen new global p tioning system (GPS) sate navigation systems that claim to get out of traffic jams.

The concept is compelling and wic used in Europe and Asia. If you tal navigation system that can calculate best route to your destination and giv information about accidents and cong tion, it should be able to figure out a v around them.

In practice, it's not that simple. T U.S. and Canada are playing catch-up cause they have no national network sensors to monitor roads. Instead, traffic data signal must be pieced toge er from a mishmash of public and priv sources, including news helicopters a police reports. And for the driver, syste that can handle traffic data are still re

ely expensive, and some can be devil-
ly difficult to set up and run.

My travel mates could calculate the
test or shortest route to a destination,
play that route in color on a map, and
mpt me with spoken directions. In ad-
ion, they all can receive and decode
ffic data where available and overlay
t information on the map.

Typically, traffic flow is shown as a col-
outline on or alongside your route: For
mple, a red line means traffic is mov-
; at less than 20 miles per hour; green,
r 45 mph; and yellow, something in
ween. Traffic incidents, such as stalled
s or construction zones, show up as di-
ond- or triangle-shaped caution signs,
sometimes simply colored dots.

S MASTER'S VOICE

TRIED OUT TWO kinds of systems:
se that come with or can be built into
s, and portable ones that stick to the
ndshield and plug into the cigarette
hter. I ended up with a favorite in each
egory. One is the navigation system
t comes standard in the Acura RL, the
0,000 flagship of Honda's luxury
nd. The other is a big-screen portable
m Cobra, a relative newcomer to the
vigation business.

The Acura system recognizes more
n 500 voice commands, plus every city
d street name in the U.S. That means
u can enter your destination, for exam-
, by saying "Two-Oh-Three North
oadway." The others require you to
ch a keyboard shown on the liquid-
stal-display screen, or worse, pick out
mbers and letters by turning a knob.

Acura's was the first to incorporate
ffic data when it came out last fall, and
s even better in this month's 2006 mod-
Acura changed the colors that indicate
ads and traffic flow to better distinguish
e two. (Earlier, it used a red outline next
a red road.) One quibble: To avoid traf-
, you have to call up a separate menu
d locate the "detour" button.

Pioneer's AVIC-N2, an entertainment
d navigation system designed to replace
e radio in your car, comes in a close sec-
d. It lists for $2,200 but you can find it
r as little as $1,300 at some Internet re-
lers. You'll also need to buy a $300 Pio-
er satellite receiver to get the traffic data
d pay several hundred dollars to have
erything installed. But it's cool: The
de-screen, 6.5-inch display pops out of
e dashboard at the push of a button.
ou can also play DVDs on it.) You can store and call up to 100 destinations by voice, and when it encounters congestion or a traffic incident, the system asks if you want it to offer an alternate route.

I also drove a 2005 Cadillac CTS, the only other new car that comes with a traffic-capable navigation package, a $3,125 option. But, with dials and buttons instead of a touch screen, entering new addresses is a chore. Another problem: It displays yellow caution icons where traffic is moving less than 45 mph. During rush hours, the icons can obscure the major highways.

All three systems get traffic data from XM Satellite Radio. It costs $4 on top of the $13 monthly subscription for audio channels, or $10 a month for the traffic alone. Get the salesman or an installer to set up the system for you.

The portable models from Cobra, Garmin, and TomTom work much like the on-board car systems, but they're cheaper and can be moved from car to car. The traffic service costs around $50 or $60 a year, about the same as XM's $4 monthly add-on. It comes from giant Clear Channel, which owns nearly 1,200 radio stations across the U.S.

I liked the idea of TomTom's GO 300, which usually sells for $550 to $600. With a 3.5-inch LCD screen, it's small, and it runs on batteries, so you don't need to plug it in except to recharge it. But I can't recommend it. The display washed out in bright sunlight, so you'll have to rely solely on its voice during the day.

Worse, it was a nightmare to set up. For traffic, you have to own certain models of cell phones that can fetch updates and transmit them via Bluetooth to the GO 300. I struggled on and off for three days. Finally, a TomTom techie told me that I had to subscribe to a specific data package from my cell company; for Cingular, that's an extra $20 a month. Oh, yes, you can't make phone calls and get traffic updates at the same time.

Cobra's NAV ONE 4500 and Garmin's StreetPilot 2720, which each sell for $800 to $1,000, use a more straightforward approach. The traffic info travels along with FM radio broadcasts from Clear Channel stations in 48 of the top 50 markets. An FM antenna and receiver pick it off the air and feed it to the navigation system.

I preferred the Cobra, mostly for its big, bright 5-inch screen and its built-in radio receiver. (The Garmin receiver is $200 extra and needs to be installed between your car antenna and radio.) When you encounter traffic, a pop-up on the screen and a voice give you three options: Keep driving, reroute me, or give me a couple of new routes and let me pick one.

Either would be a good choice if you're tired of being stuck in traffic—and not in the market for a new Acura right now. ■

What's the Holdup?

New navigation tools deliver real-time traffic information, such as collisions, construction, and congestion. Here's how:

SATELLITE RADIO

XM Satellite Radio broadcasts its XM NavTraffic data for 22 metro areas to on-board navigation systems in such new cars as the Acura RL and Cadillac CTS or those with built-in aftermarket systems from Pioneer. Sirius Satellite Radio will start a similar service in November.

SERVICE $10/month ($17/month for audio channels and traffic data)
PIONEER $1,300-$2,000

FM RADIO

Clear Channel Traffic is transmitting data in 48 top markets in the background of existing FM radio programs. Portable navigation displays from Garmin and Cobra can receive and decode it.

SERVICE $50-$60/year
COBRA $800-$1,000

CELL PHONES

Portable, windshield-mounted navigation systems from TomTom can get Clear Channel's traffic data by linking to popular Bluetooth-equipped cell phones and downloading it over the Internet.

SERVICE $50/year (plus cell-phone charges for data transmission)
TOMTOM $550-$600

A Snorer Speaks

Humorist Rob Simon talks about his quest to give his wife a quiet night's sleep

"SLEEP ANGEL" Simon tried a strap to hold his mouth shut

Humor writer and "life-long snorer" Rob Simon estimates he has spent five years and $5,000 (including bouquets of flowers for his sleep-deprived wife) in his search for a snoring cure. After undergoing three major operations on his nose and throat and a range of treatments including nasal dilators and magnet therapy, Simon still snores, though less severely. Realizing that snoring afflicts 40% of the adult population, Simon turned his research and experiences into a book, *Snore No More!* (Andrews McMeel, $12.95). Simon talked with reporter Elizabeth Woyke from his home in Denver.

Is there a "one-size-fits-all" treatment?
Since snoring is caused by so many factors, there is no silver bullet—although my wife would probably like to use a silver bullet on me every now and then. It could be that you're overweight, that you smoke, or that you have liquor before bedtime. You'll have to go through a process of elimination. You may need a doctor to determine if you have any kind of structural problems in your mouth that need to be fixed.

Who's the best authority on snoring?
It depends. If you go to an ear, nose, and throat doctor, he'll probably look at surgery and other things that involve his profession. If you go to a dentist, he'll probably provide some sort of oral medical device. If you go to a car mechanic, he'll probably say: "We can put a muffler in there that will stop it."

What's the cheapest and easiest cure?
Most people see an immediate reduction in snoring by sleeping on their side. You can train yourself to do that by wearing a pocket T-shirt backwards and putting a tennis ball in the pocket. Also, lose weight and don't smoke.

What's a good strategy for people will to invest more time and money?
First, go to a sleep clinic for a test cal polysomnogram. That can determin actly how many occasions you hav snoring at night, how bad it is, and w causing it. Also it can monitor whe you're losing any oxygen or having s apnea [cessation of breathing du sleep that lasts 10 seconds or more]. if you do need an operation, most in ance companies will want proof fro sleep clinic that you indeed have a medical problem.

How was your sleep clinic experience?
Kind of funny. I sho up at 10 p.m. The r was bright white. guys put me on an operating table, w me with electrodes, and monitored me soon as I fell asleep and they tracked snoring, they woke me up and put m another device to see if they could s me from snoring again. It wasn't a res experience. But I learned I had mini neas that obstructed my breathing night and that my snoring was loud on a scale of 10. It convinced me this a serious quality-of-life issue and m me seek more treatments.

What was the strangest remedy you tri
A Sleep Angel—a strap that goes o your head and keeps your mouth shu night. You're more likely to snore if breathe through your mouth, so it ma sense that if you keep it shut, you'll st But numerous times during the evenin felt like I was choking because I coulc catch my breath.

Have there been any recent "breakthrough" treatments?
I recently went to a conference with 6,0 sleep professionals and talked with a d tist who specializes in making mandib lar-advancement devices [plastic mou pieces that help reposition the jaw prevent snoring]. And he was telling how there's a huge shift toward oral vices. There are also relatively new ren dies such as somnoplasty, which uses dio frequency waves to reduce the tiss in the back of your throat, and injecti snoreplasty that injects a chemical age that reduces and stiffens the upper s palate. Is there a consensus in the sle community? I don't think so. ■

BusinessWeek online For a longer version of this Q&A with author Rob Simon, go to www.businessweek.com/extras

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Building a Focused Fund Of Your Own

Portfolios of under 50 stocks have outrun the market with less risk. Here's how they do it. **BY LEWIS BRAHAM**

NO ONE EXPECTS THE Janus Twenty Fund to be a stable investment. This concentrated mutual fund of just 30 stocks, which normally holds 20 to 30 positions, soared during the 1990s bull market, then plunged during the subsequent bear market. But in recent years it has done something even more remarkable: By most statistical measures, it is now less volatile than the market in general. With more attention to the mix of stocks and not just the stocks themselves, "I run a more balanced portfolio today than I did in the 2000-02 bear market," says manager Scott Schoelzel. "That helps keep our portfolio from bouncing around."

A low-risk concentrated portfolio may sound like a contradiction in terms. After all, the belief in diversification as a way to reduce risk is sacrosanct, and the average domestic equity fund holds 175 stocks. But academic studies show that as few as 50 stocks can give a portfolio volatility levels equal to those of the Standard & Poor's 500-stock index. And many funds get by with less. A screen of those with fewer than 50 stocks on fund tracker Morningstar's database found that more than half had lower betas—a measure of risk—than the S&P 500. One-third had lower standard deviations—which Morningstar measures as the month-to-month variation in the price of fund shares. What's more, according to a 2004 Morningstar study, some 80% of concentrated funds—also known as focused funds—outperformed their peers from 1993 through 2003.

More upside with less downside is every investor's goal. So how are these fund managers doing that? *BusinessWeek* asked some who had high returns with low risk for tips. Follow their advice, and you might be able to build a winning concentrated portfolio of your own.

KNOW THE COMPANIES

EVERY CONCENTRATED-FUND manager agrees that knowing the companies as thoroughly as possible—a strong grasp of their financials, their products, their suppliers, their managers, and customers—is key to controlling risk. The best managers know much more about their 10th-largest holding than the average fund manager does about his 100th. They have to because any blowups can wreck their portfolios. And because they do know more about their companies, the chances of getting hit with a nasty surprise are less than at more diversified funds.

For instance, portfolio manager Bill Frels of the 41-stock Mairs & Power Growth Fund in St. Paul, Minn., believes the familiarity factor is so important that two-thirds of the companies he invests in are located in the upper Midwest. He says the frequent contact he has with corporate managers helps him to avoid "Enron- or WorldCom-type" situations. It also gives him greater insight into their businesses than can be had by Wall

> It helps to know the company: "Numbers don't have a face"

ILLUSTRATION BY BRIAN STAUFFER

eet analysts who just crunch numbers m financial statements. "When you're king at a computer to pick your in- tments, you don't know what's behind numbers," he says. "The numbers n't have a face."

Unlike portfolio managers, most indi- ual investors will not have access to Os. Still, that's not the only way inside. esting in your own backyard is one ap- ach. Some find insights into compa- s they know through the workplace— , a competitor, customer, or supplier. l others invest in companies based on ir familiarity with its products—such Warren Buffett and his love of Coca- a. The danger of such investing, says ls, is that you may adore the company l lose the detachment needed to ana- e it objectively. So he always compares financial results of his locally owned npanies with competitors m outside the region. If y are underperforming, l drop the stock.

VERSIFY AMONG CTORS

ONCENTRATED portfolio be well diversified, while iversified portfolio can be concentrated. How's t? "In 2000, the S&P 500 s 35% in tech stocks," s portfolio manager Tom rsico of the Marsico Fo- Fund, which holds just stocks. "Even though ple thought it was a di- sified index, it was highly centrated." By contrast, rsico doesn't like to have re than 20% of his hold- s in any one industry: "That's the key my keeping risk under control." Even hin broad sectors such as health care financial services, Marsico tries to keep ix of sub-sectors that react differently market conditions. His top biotech ck, Genentech, behaves differently n Zimmer Holdings, which makes dical devices.

anus Twenty's Schoelzel employs a ilar strategy, limiting individual sector osure to 25%. But he takes the addi- al step of studying how the sectors in portfolio interact or "correlate" with h other. "Some of our bear market un- performance came not from tech cks but from financial services," he s. "Investment banks that underwrote public offerings of tech stocks fell t alongside them."

Schoelzel now employs risk managers to monitor correlations between stocks and sectors. If stocks in two sectors are moving too much in tandem, he lightens up his positions.

Individual investors can study correlations and volatility at a free Web site, riskgrades.com. The site assigns each stock a "risk grade" and then one for your portfolio. Ideally, the risk grade of the whole should be less than the average of the parts. One caveat: Risk is always changing, so you need to monitor it. For instance, risk grades for stocks in the energy sector have recently surged, and they're even higher than those for technology stocks.

MARGIN OF SAFETY

VALUE MANAGERS HAVE their own form of risk control called the "margin of safety" that's straight out of financial textbooks. They'll buy a stock only at a deep discount to what they perceive is its "intrinsic value," or the price it would fetch in a private acquisition. The idea is to buy at prices so low they have little room to fall. Because of this strategy, the top-performing Fairholme Fund has one of the lowest betas, 0.51, of any equity fund, even though it holds only 29 stocks and has a hefty 34% position in the financial services sector.

Fairholme portfolio manager Bruce Berkowitz says one of the best examples of how he employs the margin-of-safety principle is the fund's purchase of telecom giant WorldCom. When the company emerged from bankruptcy last year as MCI, it traded for $13 a share, even though it had $16 a share in cash and little debt. That meant the market was pricing the stock as if WorldCom's telecom business were worth less than nothing. "That cash was our margin of safety," says Berkowitz.

DIVIDENDS

STOCKS THAT PAY dividends are generally less volatile than ones that don't. For one thing, the cash flow from the dividend cushions the portfolio in bear markets. In addition, many investors who own these stocks hold them for the long term so they can collect their payouts, thus reducing the daily volatility caused by active traders.

With a heavy emphasis on dividends, the TCW Galileo Dividend Focused Fund has a low beta and standard deviation despite holding only 48 stocks. Manager Diane Jaffee takes additional risk-control measures, such as capping any one sector at 35% of the portfolio and looking beyond the dividend to see if there's a catalyst for improving business prospects. "Our weightings in traditional dividend stocks such as utilities and financial services are lower than our peers," she says. "So we're actually more diversified than they are." In fact, about 14% of the fund is in tech stocks, which is unusual for dividend-oriented funds.

"ECONOMIC MOATS"

GROWTH-STOCK INVESTORS have their own defense mechanisms. Robert Millen, co-manager of the 28-stock Jensen Fund, buys only companies that have delivered a return on equity of at least 15% a year for the past decade. Companies with that kind of profitability, he says, are not necessarily cheap, but they are more resistant to market downdrafts. Says Millen: "We're buying quality companies at a rea-

Few Stocks, Lower Risk—And Mostly Higher Returns

Concentrated funds offer great lessons to individuals managing their own portfolios. But if you would rather invest in these funds than mimic them, here are some of the best. Beta measures volatility of the fund vs. the S&P 500; a fund with a 0.67 beta is only two-thirds as volatile as the broad market. With standard deviation, the lower the number, the more stable the fund's month-to-month returns. All of these funds have a lower standard deviation than the S&P 500.

FUND/SYMBOL	CATEGORY	AVERAGE ANNUAL TOTAL RETURN*	BETA*	STANDARD DEVIATION*	PORTFOLIO HOLDINGS**
Brandywine Blue (BLUEX)	Large-cap Growth	17.71%	0.67	12.72	34
Fairholme (FAIRX)	Mid-cap Value	18.70	0.51	9.58	29
Janus Twenty (JAVLX)	Large-cap Growth	16.31	0.84	12.85	36
Jensen Fund (JENSX)	Large-cap Growth	7.87	0.79	11.37	28
Mairs & Power Growth (MPGFX)	Large-cap Blend	15.12	0.79	10.75	41
Marsico Focus Fund (MFOCX)	Large-cap Growth	12.28	0.70	11.67	26
TCW Galileo Div. Focused (TGIGX)	Large-cap Value	16.71	0.79	11.64	48
Standard & Poor's 500 Index	Large-cap Blend	12.61	1.00	13.07	500

*For three years ended July 31, 2005. Returns are annualized and include appreciation plus reinvestment of all dividends and capital gains before taxes
**As of July 31, 2005

Data: Morningstar

sonable price. They don't vary much from year to year in terms of their financial performance—whether the market goes up, down, or sideways."

These companies often succeed because they have competitive advantages or "economic moats" that protect their businesses. Millen's top holding is Stryker, the dominant player in the orthopedic implant industry. True, it has patents protecting many of its products from competitors, and patents eventually expire. But what won't change is the growing ranks of seniors, who are the main customers for Stryker's products. Among the Jensen Fund's other moat-protected holdings are General Electric, Procter & Gamble, PepsiCo, and Anheuser-Busch.

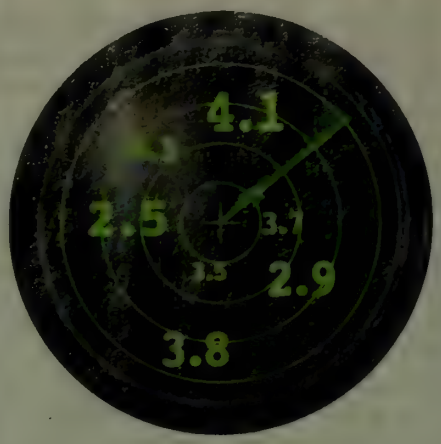
DEFENSIVE TRADING

MANY INVESTORS would not associate frequent trading with low-risk portfolios. But portfolio manager Bill D'Alonzo of the 34-stock Brandywine Blue Fund keeps risk in check with lots of buying and selling. The fund's annual turnover ratio is 247%, which means the average stock is held for just five months. "We're constantly weeding out stocks that have hit our price targets or have stumbled," he says.

> Risk is always changing, so you have to monitor it

Here's how the defensive trading works. D'Alonzo first bought wireless company Nextel at 15 a share in June, 2003, then sold it in December of that year when it hit his 26 price target. In June, 2004, the stock dropped 20% on worries about a competing technology. D'Alonzo, deciding the concerns were insignificant, purchased the stock again at around 21. He sold it once more late last year for a 17% gain when news broke that Sprint would be acquiring Nextel.

D'Alonzo keeps a close eye on valuations. If one of his holdings trades above 30 times his estimate of the next 12 months' earnings, he'll often unload it and look to buy it back at a lower price. But he'll also push the button if normally chatty company executives clam up or if an outfit starts slashing prices to move products. Worse yet, if the company has an ugly earnings report that is not the result of a one-time event, he'll sell. "If you spot one cockroach," he figures, "that probably means there's more."



There's Real Juice In CDs

With short-term rates rising, yields from certificates of deposit beat those of bonds. **BY LAUREN YOUNG**

WOULD YOU rather lock up your money in a 10-year U.S. Treasury bond yielding 4.2% or stash it in a one-year, insured certificate of deposit with the same interest rate?

Finally, there's some juice in short-term investments. Nan Sabel, a financial adviser in Bedford, Mass., recently recommended that clients invest in one-year CDs yielding 4.4% offered by Countrywide Bank. And Susie Johnston, a financial adviser in Littleton, Colo., just started moving her clients' cash into nine-month brokered CDs offered through Charles Schwab yielding 3.9%. "CDs are much better than money markets and are not as risky as bond funds," says Johnston.

Higher short-term yields are the result of 10 consecutive rate hikes from the Federal Reserve, and at least several more are expected. In a rising-rate environment, the best advice is usually to stay in the shortest-term investments, namely money-market funds and U.S. Treasury bills. But at this point in the interest-rate cycle, one-year maturities will give you close to a percentage-point pickup above money-market rates without locking you in for a long time in the event that interest rates move hig

Since May, average yields on one-y CDs have risen more than a quarter percentage point, to 2.98%, while yi on longer-term CDs—including th with five-year maturities—have ba budged, according to Bankrate.com. sweet spot extends to two-year CDs, yielding an average of 3.35%.

But don't bother going out any furt on the yield curve. The difference tween the yields of two-year and th year CDs is only 0.17 points. So vestors should have no reason to beyond two years a CD," says Pat Ifrah, president Hutchinson Ifrah nancial Services Little Rock.

And as the Co trywide Bank a Schwab examples lustrate, don't se for average yie Instead, use them a benchmark. T best one-year C are yielding m than a percenta point above the av age CD. To find banks with the most ticing yields, go to Bankrate.com. "T highest-yielding CDs might not be at bank around the corner, but they are p fectly safe and FDIC-insured," says L ra Bruce, an analyst at Bankrate.com.

Keep in mind that CDs are not as l uid as money-market funds. Because y pay a penalty for an early withdraw think about your upcoming cash nee before locking in.

The Best Returns On One-Year CDs

INSTITUTION	YIELD	MINIMUM
Corus Bank corusbank.com	4.52%	$10,000
Nexity Bank nexitybank.com	4.45	1,000
Ascencia Bank ascenciabank.com	4.40	500
Umbrella Bank umbrellabank.com	4.38	1,000
Advanta Bank advantabankcorp.com	4.38	10,000

Data: Bankrate.com

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OLF

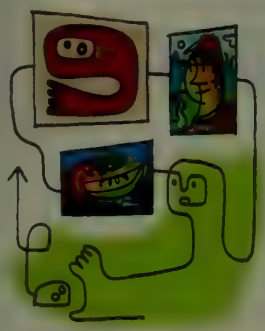
ET YOUR IRONS ITCH A RIDE

LF CLUBS TOO BIG to squeeze into your with all your other gear? Attach tolinx ($295, **drivelikeapro.com**) to back of your car, then pop your bs inside the special hard-shell e. And for those road trips with your fing buddies, a separate hitch achment will let you transport up four sets of clubs on a single rack. tra cases are sold separately ($295 h). —*Dean Foust*

ME OFF

OING DIGITAL IN NDIANAPOLIS

E INDIANAPOLIS MUSEUM of Art (ima-.org; 317 920-2660) now has digital ls once reserved for a sci-fi movie. In new X Room, images of modern and ssical art are projected on the walls d on a table. Using a paddle that acts a computer mouse, you can zero in a piece and find its location in the useum. In "Cabinet of Teams," for ample, useum goers n view 3-D phics of inese iquities ng arized sses. Art ers who can't live without their ackBerries will welcome a program t allows you to retrieve information a PDA. Crowding around text unted on a wall is so 20th tury. –*Monica Gagnier*



INVESTING

Watch That DRIP

DIVIDEND REINVESTMENT PLANS, or DRIPs, are a great way to build wealth. They allow you to use the quarterly payments to acquire more shares in a company, and odd amounts are no problem, since the plans buy fractional shares. But be sure to look at the details. Of the roughly 1,100 DRIPs, around half charge fees to invest the dividend, and they can be deceptively steep.

The biggest offenders are direct purchase plans, a type of DRIP that lets you invest in a company even if you don't already own any shares. Most charge 1% to 5% of the value of the investment, and sometimes a per-share fee to cover brokerage costs. **IBM**'s direct purchase plan levies 2%, up to a maximum of $3. **Campbell Soup** and **FedEx** both tack on a 5% reinvestment fee, up to $3—plus commissions.

That can add up, especially on small accounts. Charles Carlson, editor of the *DRIP Investor* newsletter, figures fees up to 2% are acceptable. If you already own stock in a high-fee plan, he advises taking the cash and channeling it to another stock. Spending $5 to invest $100 in dividends is no way to get rich. –*Adrienne Carter*

STOCKS

U.S. CORPORATIONS get brownie points for having so much cash on their balance sheets, and that is often cited as reason to be bullish on the stock market. But the truth is that the money is in relatively few hands (table). According to Banc of America Securities chief equity strategist Thomas McManus, just 10 companies hold 25% of all the cash held by companies in the Standard & Poor's 1500-stock index (excluding financial firms).

The Largest Cash Holdings

COMPANY	CASH BALANCE (BILLIONS)
Ford	$38.5
Microsoft	37.8
General Motors	35.9
ExxonMobil	30.3
WellPoint	16.6
Aetna	16.4
Intel	14.8
Pfizer	14.6
Hewlett-Packard	14.5

Data: Banc of America Securities

BY MARA DER HOVANESIAN

TIMES ARE GRIM FOR RETAILERS. SO WHY FOCUS ON TARGET?

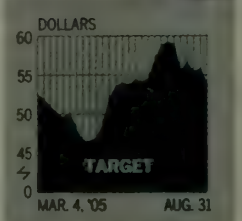
KINETIC CONCEPTS IS SET TO BIND UP SOME OLD WOUNDS.

THE FACTORIES ARE HUMMING AT ILLINOIS TOOL WORKS.

Taking Aim at Target

AS OIL CONTINUES its rampage, squeezing shoppers' budgets, the outlook for retailers looks bleak. In fact, when oil hit $70 a barrel on Aug. 30, retail stocks had the second-worst showing among all industry groups in the Standard & Poor's 500-stock index. "We think investors should be increasingly selective with retail," says Mark Miller of brokerage William Blair. Target (TGT) dropped $1.58, to 54.14, that day and a further 40¢ the next day, even though the S&P 500 rose 1%. But the sell-off may be a good time to buy in. Miller expects same-store sales to increase by 5.8% for 2005, vs. a 5.3% gain last year, at a time "that is shaping up to be pretty challenging for everyone else." Target, with its 1,351 stores, is a discounter that appeals to middle- and high-income types, so oil prices aren't such a hit to the wallet, says Miller. The company's ad campaign resonates with shoppers, he adds, as do partnerships with high-end brands such as garden-furniture maker Smith & Hawken and designers like Isaac Mizrahi. Target also has strength in procurement and factory management with its foreign suppliers. Miller's earnings estimate is $2.68 a share for 2005 and $3.08 for 2006. He doesn't issue price targets. Another bull, Bill Dreher of Lehman Brothers, has a 12-month price target of 68.

A RECENT SELL-OFF



Data: Bloomberg Financial Markets

Healing Ahead For Kinetic Concepts

KINETIC CONCEPTS (KCI), which markets wound-healing and tissue-repair devices, was a health-care darling at its initial public offering in February, 2004, which raised $540 million. Then at 30, the stock now trades at 55. Kinetic specializes in trauma wounds, amputations, and ulcers—and serves hospitals through 138 U.S. and 69 overseas service centers. Jordan Estra of Stanford Group says Kinetic's business will explode with new applications for foot wounds of bedridden diabetics. It has "an excellent technology and business structure" says Estra, whose price target is 85. But the stock, down from 76.30 on Dec. 31, has been hit by concerns that it could lose lucrative home-care reimbursements with the downsizing of Medicaid. And although Kinetic filed a patent-infringement lawsuit against San Diego rival BlueSky, investors are still jittery about new competition. Estra says Kinetic has won a similar case in Europe. And even if it loses, diabetes treatment remains a huge market. Ryan Rauch of Jefferies, who reiterated his 75 target on Aug. 30, adds: "The shorts are all over it, but it's better than people believe." Second-quarter profits of $39.8 million beat Wall Street and were up 66% from a year ago. Rauch sees earnings of $2.24 a share for 2005 and $2.78 for 2006. The stock is cheap, he says, trading at times earnings, with earnings growth of 25%.

PLENTY OF UPS AND DOW

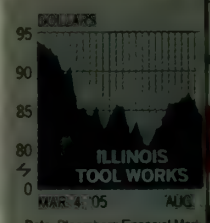
Data: Bloomberg Financial Mar

Illinois Tool Works Is on Solid Ground

IF YOU'RE LOOKING FOR a diversified manufacturer th could benefit from the expanding economy, go no furth than Illinois Tool Works (ITW). From heavy machinery t plastic drink containers, it makes products at 650 companie worldwide. But the stock has been weak on worries that 49% its revenues comes from the real estate and automotive indu tries—both under pressure. But Robert McCarthy of broker Robert W. Baird, who has a price target of 109 on the stock, now at 84, says ITW's U.S. real estate is mainly commercial construction, less vulnerable than homebuilding to falling prices. Automotive revenues, 18% of sales, derive mostly from South America. Brian Langenberg of Foresight Research Solutions pegs the price at 105 to 110. "This is a bricks-and-mortar company, and they do it well," he says. The stock trades at 16 times its 2005 estimates, vs. its historic range of 17 to 25 times forwar earnings. ITW expects earnings of $5.02 to $5.14 a share, mainly because of higher income from leasing and investing The IBES consensus earnings estimate for 2006 is $5.61. ■

Gene Marcial is on vacati

IT TOOK A HAMMERING



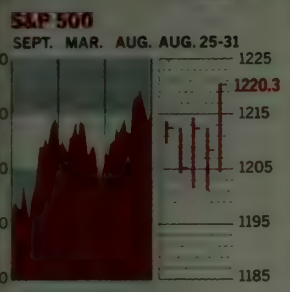
Data: Bloomberg Financial Mark

BusinessWeek online Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor the firms hold positions in the stocks under discussion. Similarly, they have no investme banking or other financial relationships with them.

igures of the Week

TOCKS



MMENTARY

id news of Hurricane rina's devastating impact on Gulf Coast and surging oil es, the markets focused on d news. Signals that the Fed ght soon stop raising rates l the release of oil reserves by sident Bush sent the Dow l the S&P up 0.4% and 0.9%, pectively, while the tech- en Nasdaq rose 1.1% for the ek ended Aug. 31.

: Bloomberg Financial Markets, Reuters

U.S. MARKETS	AUG. 31	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1220.3	0.9	0.7	10.5
Dow Jones Industrials	10,481.6	0.4	-2.8	3.0
NASDAQ Composite	2152.1	1.1	-1.1	17.1
S&P MidCap 400	711.5	1.3	7.3	23.4
S&P SmallCap 600	347.4	1.9	5.7	25.3
DJ Wilshire 5000	12,199.1	1.0	2.1	13.6
SECTORS				
BusinessWeek 50*	733.8	1.9	4.1	15.8
BW Info Tech 100**	363.9	0.7	-2.5	13.5
S&P/BARRA Growth	504.4	0.9	0.4	8.7
S&P/BARRA Value	631.7	0.9	1.0	12.3
S&P Energy	381.1	3.6	32.0	49.1
S&P Financials	393.5	0.0	-4.3	1.5
S&P REIT	153.1	1.4	6.0	19.3
S&P Transportation	214.5	-1.3	-11.2	6.1
S&P Utilities	164.3	1.9	16.0	29.7
GSTI Internet	174.4	2.1	-2.2	27.8
PSE Technology	808.6	1.8	3.6	24.1

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	AUG. 31	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1420.7	0.2	1.7	24.8
London (FT-SE 100)	5296.9	0.4	10.0	18.8
Paris (CAC 40)	4399.4	-0.6	15.1	22.4
Frankfurt (DAX)	4829.7	-1.8	13.5	27.6
Tokyo (NIKKEI 225)	12,413.6	-0.7	8.0	12.0
Hong Kong (Hang Seng)	14,903.6	0.2	4.7	16.0
Toronto (S&P/TSX Composite)	10,668.9	1.5	15.4	27.4
Mexico City (IPC)	14,243.2	-2.5	10.3	38.8

FUNDAMENTALS	AUG. 30	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	2.05%	2.05%	1.72%
S&P 500 P/E Ratio (Trailing 12 mos.)	18.9	19.0	19.6
S&P 500 P/E Ratio (Next 12 mos.)*	15.1	15.2	16.2
First Call Earnings Revision*	0.47%	0.50%	-2.66%

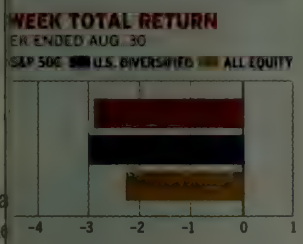
*First Call Corp.

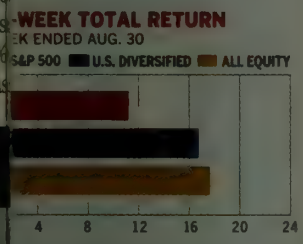
TECHNICAL INDICATORS	AUG. 30	WEEK AGO	READING
S&P 500 200-day average	1195.4	1194.4	Positive
Stocks above 200-day average	59.0%	62.0%	Neutral
Options: Put/call ratio	0.87	0.83	Positive
Insiders: Vickers NYSE Sell/buy ratio	5.18	5.25	Negative

BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Oil & Gas Refining	24.9	Oil & Gas Refining	130.8
Instrumentation	12.1	Oil & Gas Exploration	79.2
Oil & Gas Exploration	7.9	Fertilizers & Ag. Chems.	74.4
Oil & Gas Equipment	6.6	Oil & Gas Drilling	74.2
Gold Mining	5.4	Managed Health Care	70.7

WORST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Home Frnshngs. Retailers	-11.7	IT Consulting	-33.8
Specialty Appar. Retailers	-10.3	Insurance Brokers	-23.7
Genl. Merchandise Chains	-9.3	Automobiles	-23.6
Department Stores	-9.2	Motorcycles	-19.3
Homebuilding	-9.0	Photographic Products	-17.6

UTUAL FUNDS





: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Japan	5.0	Latin America	61.6
Diversified Pacific/Asia	0.7	Natural Resources	52.3
Precious Metals	0.6	Diversified Emerg. Mkts.	39.1
Natural Resources	0.5	Utilities	30.8
LAGGARDS		LAGGARDS	
Real Estate	-5.9	Precious Metals	7.1
Small-cap Growth	-4.1	Financial	8.5
Small-cap Value	-3.8	Domestic Hybrid	9.7
Small-cap Blend	-3.8	Japan	11.4

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Oppenheimer Rl. Asst. A	13.3	Guinness Atkn. Gl. Energy	85.0
Rydex Commodities H	13.1	BlackRock Gl. Res. Inv. A	78.0
ProFds. USh. Sm. Cap Inv.	10.8	U.S. Glbl. Invs. Gl. Rscs.	76.8
Potomac Sm. Cap/Sh. Inv.	10.7	ProFunds Oil & Gas Inv.	74.5
LAGGARDS		LAGGARDS	
ProFunds Real Est. Inv.	-10.9	ProFds. USh. Mid Cap Inv.	-33.2
ProFunds Sm. Cap Inv.	-10.3	ProFds. USh. Sm. Cap Inv.	-32.8
Alpine U.S. Rl. Est. Eq. Y	-10.0	Rydex Dyn. Vent. 100 H	-24.9
Fidelity Sel. Cstr. & Hsng.	-9.4	ProFunds UltSh. OTC Inv.	-24.7

INTEREST RATES

KEY RATES	AUG. 31	WEEK AGO	YEAR AGO
Money Market Funds	3.04%	3.00%	1.02%
90-Day Treasury Bills	3.50	3.49	1.58
2-Year Treasury Notes	3.82	3.97	2.40
10-Year Treasury Notes	4.02	4.17	4.12
30-Year Treasury Bonds	4.26	4.39	4.93
30-Year Fixed Mortgage †	5.71	5.73	5.81

†BanxQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.66%	4.33%
Taxable Equivalent	5.21	6.19
Insured Revenue Bonds	3.81	4.46
Taxable Equivalent	5.44	6.37

THE WEEK AHEAD

MANUFACTURERS' INDEX *sday, Sept. 6, 10 a.m. T* » The Institute for Supply agement's August manufacturing activity index is cast to have improved to %. That's according to the ian forecast of economists eyed by Action Economics. July reading eased down to %. Even so, the July results wed an improvement in new rs at home and from abroad.

BEIGE BOOK *Wednesday, Sept. 7, 2 p.m. EDT* » The Federal Reserve releases its summary of regional economic activity before the Sept. 20 monetary policy meeting. Every economist queried by Action Economics expects another hike in the federal funds rate, to 3.75%, from 3.5%, and the consensus is that the Fed will pause later this year.

INSTALLMENT CREDIT *Thursday, Sept. 8, 3 p.m. EDT* » In July consumers most likely tacked on another $9.8 billion of debt. Installment credit surged $14.5 billion in June. Strong auto sales have driven the recent upswing.

EXPORT-IMPORT PRICES *Friday, Sept. 9, 8:30 a.m. EDT* » Export prices probably increased by 0.1% for a second consecutive month in August. The runup in energy prices very likely pushed August import prices up by 1.1% for a second straight time.

The *BusinessWeek* production index climbed to 252.3 for the week ended Aug. 20, and stood 12.2% above the previous-year reading. Before calculation of the four-week moving average, the index rose to 254.1.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit **www.businessweek.com/magazine/extra.htm**

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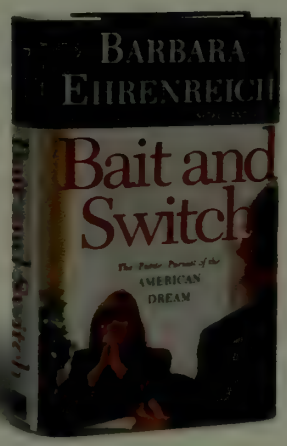
Hard at (No) Work

BAIT AND SWITCH The (Futile) Pursuit of the American Dream
By Barbara Ehrenreich; Metropolitan; 237pp; $24

We all want to believe that we're smart enough, quick enough, or lucky enough to survive the ongoing turmoil in the job market. We hear tales of executives ejected from their companies who can't find positions that satisfy them. But we imagine that, should we be laid off, things will be different: We'll find other employment, maintain our incomes, keep our benefits.

Barbara Ehrenreich is here to tell us that chances are we won't. In her insightful but flawed *Bait and Switch: The (Futile) Pursuit of the American Dream*, she temporarily joins the ranks of the white-collar unemployed to experience their anxieties, hopes, and frustrations. Such people are caught in a "perpetual winnowing process"—they "did everything right" but still fall on hard times when they're let go from jobs they thought they deserved to keep.



The government calculates that from January, 2001, to December, 2003, 5.3 million people were "displaced" from jobs they had held for at least three years. About two-thirds had found work by early 2004, but of those, 57% were earning less than they had before. Moreover, white-collar unemployment—and the poverty that often results—is unexpected and unfamiliar, in Ehrenreich's analysis, "a rude finger in the face of the American dream." The problem is, Ehrenreich focuses too much on herself and not enough on these victims.

Going undercover once again, as she did in her 1998 best-seller *Nickel and Dimed: On (Not) Getting By in America*, the author sets out to land a "good" job—a position that pays about $50,000 a year and provides health insurance—at almost any kind of company in nearly any part of the country. She officially takes back her given name, Barbara Alexander. Then she gets a new Social Security number, crafts a résumé that exaggerates her relevant experience, and presents herself as a fiftyish public-relations professional seeking the comforts of the corporate world after years of working on her own. It's not giving anything away to tell you that she fails.

Her story, it turns out, is all about the hunt. Ehrenreich expects her job search, which takes place in 2004, to last anywhere from four to six months and to cost about $5,000 for travel and other expenses. She plans to work for about four months, then call it quits. But 10 months and $6,000 later, her sole offer is for a commission-only, work-from-home sales position at the insurance company AFLAC. At this point she concludes that, as well-educated and articulate as she is, her age and the fact that Barbara Alexander has only been a consultant make her unemployable.

During those 10 months, the author comes across a sorry assortment of career coaches. One drags out their sessions together by dissecting the punctuation in her résumé, while another gives her a cockamamie personality test. She then posts her résumé online and sends it cold to dozens and doze of companies—but doesn't manage to line up even one informational interview. Next she travels up and down the Ea Coast to participate in a series of "networking events" and jo fairs held in the most dreary places, where the only people sh meets are other job-seekers. She goes to a sparsely attended "boot camp" where participants are told their bad attitudes a holding them back. She shows up at Christian study groups that promise job-seekers divine guidance. She submits to a makeover designed to give her a more feminine appearance. She reads dozens of books on how to secure an executive position.

Such experiences are perversely fascinating, and Ehrenreich conveys them with humor and aplomb. But they don't add up to a fair test of th employment market. Who relies totally on strangers to find a job these days? Ehrenreich admits that "a normal job seeker of my age wou have acquired a Rolodex of contacts." But what she calls a "disadvantage" turns out to be a fatal flaw for *Bait and Switch*, making it too contrived be truly engaging. Moreover, unlike in *Nickel an Dimed*—where going undercover provided startling insights into the ways low-wage labore think about their jobs—this tim the approach doesn't provide much. It was easy to pose as a waitress and house-cleaner, bu not as an executive. It's clear early in the book that the newly constructed Barbara Alexander doesn't have a real shot at a desirable job.

> An insightful but flawed look into "the land of the undead," as one job-seeker calls it

Ehrenreich should have concentrated more on the men and women she met during he sojourn into "the land of the undead," as one job-seeker cal it. Most, it turns out, were no closer than she was to securing jobs by the fall of 2004. Their stories would have provided a more powerful critici of a corporate world that can leave even the smartest and quickest of us behind. ■

–By Susan Berfi

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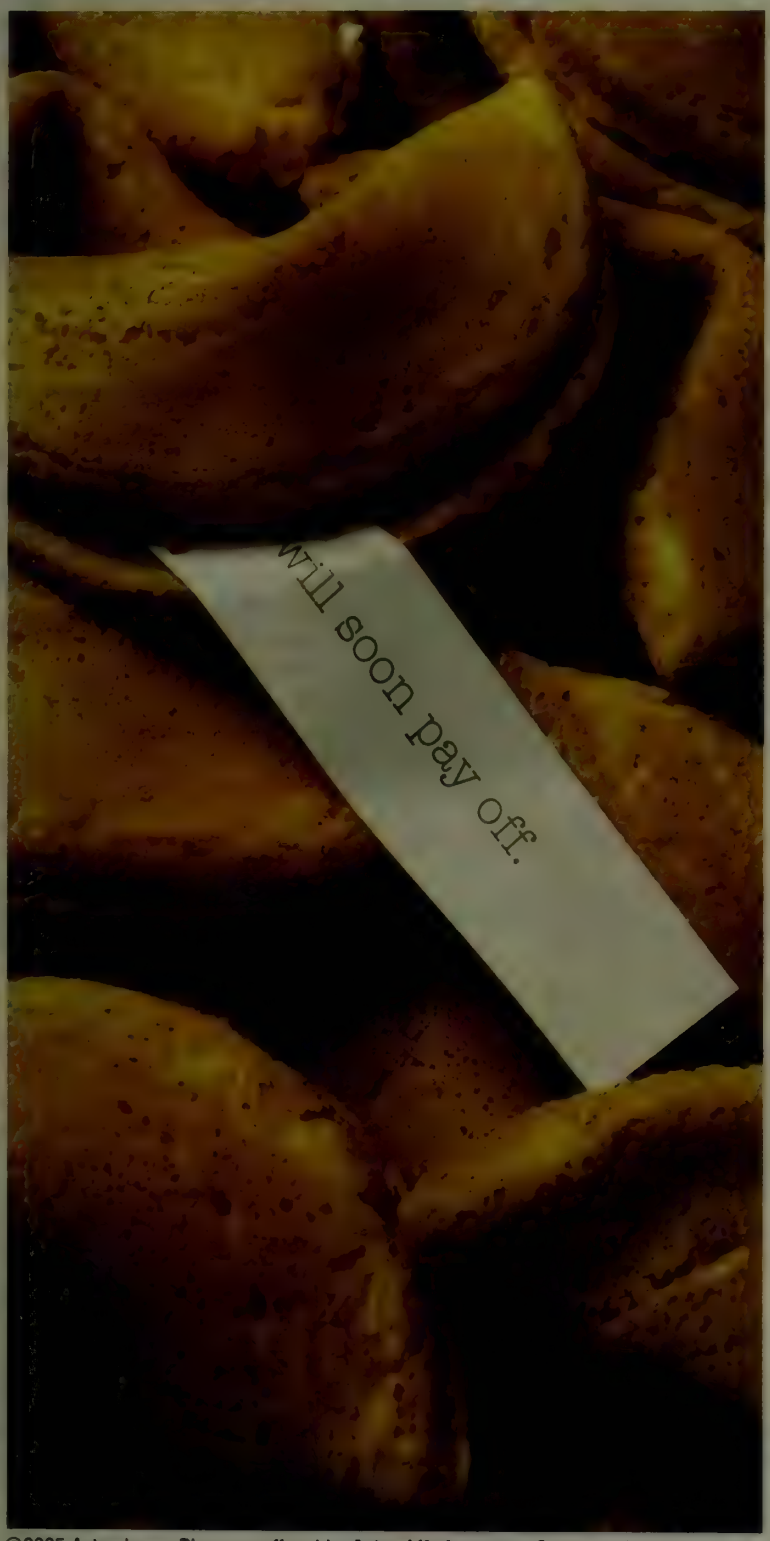

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IdeasViewpoint

BY ROBERT KUTTNER

Small Investors, Sitting Ducks

Labor Day is traditionally a time to assess the condition of wage workers. Bu in many ways, today's small investors have more affinity with the proletaria than either class has in common with the unscrupulous insiders, middlemen, and CEOs who have been fleecing both. Today, nonsupervisory worker have the same inflation-adjusted earnings they had in 2001, according to the Bureau of Labor Statistics—no real raises for four years. Many voices have suggested that workers can cushion their vulnerability by joining the investor class. But investors, if anything, have taken a worse hit. The broad stock market is still down about 18% from its peak in 2000. And no prudent investment strategy is evident. Bonds are unattractive because of low yields and the risk of rising rates. Stocks are trading within a narrow range, dividend payouts are paltry, and there's no bull market in sight. Even real estate—long a refuge for the little guy—is suddenly a gamble.

Some small investors are tempted by hedge funds, currency and commodity plays, or other exotic vehicles ordinarily used by high rollers. But the apparent fraud and collapse of Bayou Group, a hedge fund that courted relatively small investors, should signal caution—even as hedge funds resist minimal regulation.

AS THE WALL STREET SCANDALS so vividly demonstrated, small investors ought to be particularly wary of their supposed servants. The worst scoundrels were not the CEOs of outfits such as WorldCom, now finally starting prison terms. Far worse were the ostensible agents of investors, the accountants, investment bankers, and stock analysts who vouched for—and profited from—the deceptions. Regulators, with a few heroic exceptions, also let investors down. The much-extolled Sarbanes-Oxley Act, in the hands of a now docile Securities & Exchange Commission, could be a weak reed. There is already a massive campaign to roll back key provisions on the grounds that enforcement of honest capitalism is financially burdensome. (Compared to what? To trillions lost by investors in an artificially induced bubble?)

What every recent abuse had in common was that insiders and middlemen manipulated corporate books, inflating the value of stocks and getting rich at the expense of ordinary investors. Self-regulation and market discipline failed. And if enforcement against conflicts of interest is not vigilant, investors will be snookered again.

An important new book, *The Best Way to Rob a Bank Is To Own One*, introduces a valuable concept called "control fraud." The author, William K. Black, is a former Federal Home Loan Bank Board enforcement official who now teaches about corporate chicanery at the University of Texas. Black's book is partly the definitive history of the savings-and-loan industry scandals of the early 1980s. More important, it is a general theory of how dishonest CEOs, crony directors, and corrupt middlemen can systematically defeat market discipline and conceal deliberate fraud for a long time—enough to create massive damage. Although the currently fashionable Law and Economics school of thought contends that regulation only causes inefficiencies, Black's analysis reminds us that history teaches otherwise.

> It remains too easy for insiders and middlemen to commit fraud

In the S&L debacle, industry-engineered deregulation all b invited S&Ls to inflate balance sheets, overpay for brokered deposits, and make highly speculative loans. Insiders got rich. The market didn't correct the fraud, which ended when the industry was substantially re-regulated and bailed out by taxpayers to the tune of $200 billion—or almost $500 billion if you count interest.

The S&L scandals foreshadowed the broader Wall Street manipulations that followed. As Blac observes, despite a brief episode of S&L re-regulation, we did not learn the general lessons—that financial markets and self-regulati can't police systematic efforts to defraud by thos in control. So we were sitting ducks for the next barrage of control frauds by the Enrons and WorldComs, th time with blue-chip investment bankers and tame regulato as enablers. That vulnerability continues.

This Labor Day, wage workers are struggling to re-inven labor movement. America also has lobbies for doctors, accountants, retired people—indeed, it's only investors who lack an effective interest group. Investors sorely need a movement of their own to fight for transparent markets, honest books, and uncorrupted regulation. Whether in post Soviet Russia or on Wall Street, the real specter that haunts capitalism is corruption. Investors of the world, unite! ■

Robert Kuttner is *co-editor of* The American Prospect *and author of* Everything for Sale.

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IdeasEditorials

How to Converse With China

WHEN PRESIDENT Richard Nixon made his remarkable visit to China in 1972, the journey was framed as an historic cease-fire between two Cold War combatants. Barely 30 years later, the current leaders of the two nations are set to meet again on Sept. 7 in Washington. But this time, things are radically different (page 58). Now economic, not ideological, rivalries are pushing the two apart. And rather than the poor, insular country of the Nixon era, today's China is an ascendant nation that has pulled hundreds of millions of its citizens out of poverty in a generation and could eclipse America's global economic preeminence by mid-century.

Such a transformation calls for a change in the discourse between the two powers. That's why the focus of the visit to Washington by Chinese President Hu Jintao should be on areas where there is the possibility of progress, rather than on issues so divisive that no movement can be gained. President George W. Bush must broach discussions about China's continuing efforts to isolate Taiwan's government (although not its investment) and of Beijing's curbs on human rights and press freedoms. But those contested issues must not drown out the dialogue in areas where the two nations are actually making headway, such as China's recent decision to begin appreciating its currency and the increased policing of intellectual-property rights. They're a welcome start, although progress in both areas is still inadequate.

It's time to focus on the positive, and there's a lot of common ground

More places exist for reaching a common ground. In energy, for example, the interests of China and the U.S. are more aligned than many think. The U.S. uses the most now, but China is the fastest-growing major consumer. Both import much of the oil needed to fuel their power-hungry economies. So Beijing and Washington share a basic need: adequate supplies of energy at the lowest prices.

That's one reason the recent howls in Congress over the failed bid for Unocal Corp. by China's CNOOC Ltd. were so shortsighted. As Beijing invests in oil assets, here or overseas, it could eventually increase global oil production and reduce prices—benefiting the U.S. in the process. Although the Unocal deal fell prey to U.S. protectionist fears, Hu and Bush should not be afraid to use their meeting to explore other forms of energy cooperation in areas such as research on renewable fuels and conservation. Any agreement on these problems can only benefit the two nations' strained relations—and send a potent message to the rest of the world that a new day of U.S.-Sino collaboration based on mutual self-interest is dawning.

It's time for America to abandon the naive view that China is a rival that can be easily bested—or simply ignored if no Such thinking is not only improbable but also not in the be interests of America. China is in part responsible for many things Americans depend on to maintain their high standa of living—everything from state-of-the-art Dell laptops to cheap bath towels at the local Wal-Mart. And Beijing is becoming a key ally in dealing with North Korea and other volatile nations where U.S. influence is weak. Dismissing China as a global player is simply no longer an option. Instead, the two powers must build on their bruised-but-n broken base of bilateral trade to pursue mutually beneficial goals in areas such as energy, security, and the environmen

That won't be easy. But just as Nixon and Chinese leade Mao Zedong and Zhou Enlai in 1972 recognized the practi benefits of putting decades of mistrust behind them, Presidents Bush and Hu must embrace the need for a more egalitarian exchange between the U.S. and China.

Join the Real World, MBAs

IT'S NOT WHAT you know, but where you w to school. Or so believe MBA students at top ranked business schools Chicago, Wharton, Stanford, and Harvard, where students have in recent years adopted policies that preven them or their schools from revealing grades to potential employers (page 75). By doing so, they hope to create a less pressured environment and remove some of the risk from taking difficult electives.

During the dot-com boom, when lucrative job offers for MBAs were abundant, grades, it seemed, were largely besid the point. After all, when valedictorians and slackers alike shared in the bounty, the varying benefits afforded by an A-plus or a B-minus were negligible. But in today's hotly competitive job market, such differences loom large. Nonetheless, the nondisclosure policies have been passed down from year to year, with each new class viewing this radio silence on grades as its academic birthright.

The MBA experience is all about preparing for life in business. But grade nondisclosure eliminates three definin features of the business world: risk-taking, accountability, and often ruthless competition. By removing grades from t B-school equation, the students are doing themselves a hu disservice—creating the illusion of a noncompetitive world that will be shattered upon graduation when they will find themselves poked, measured, and prodded like everyone el

The irony is that these men and women will, as managers be required to take others to task for their actions, doling ou pay raises and promotions based on measurable performanc Maybe accountability is a lesson they should learn right now

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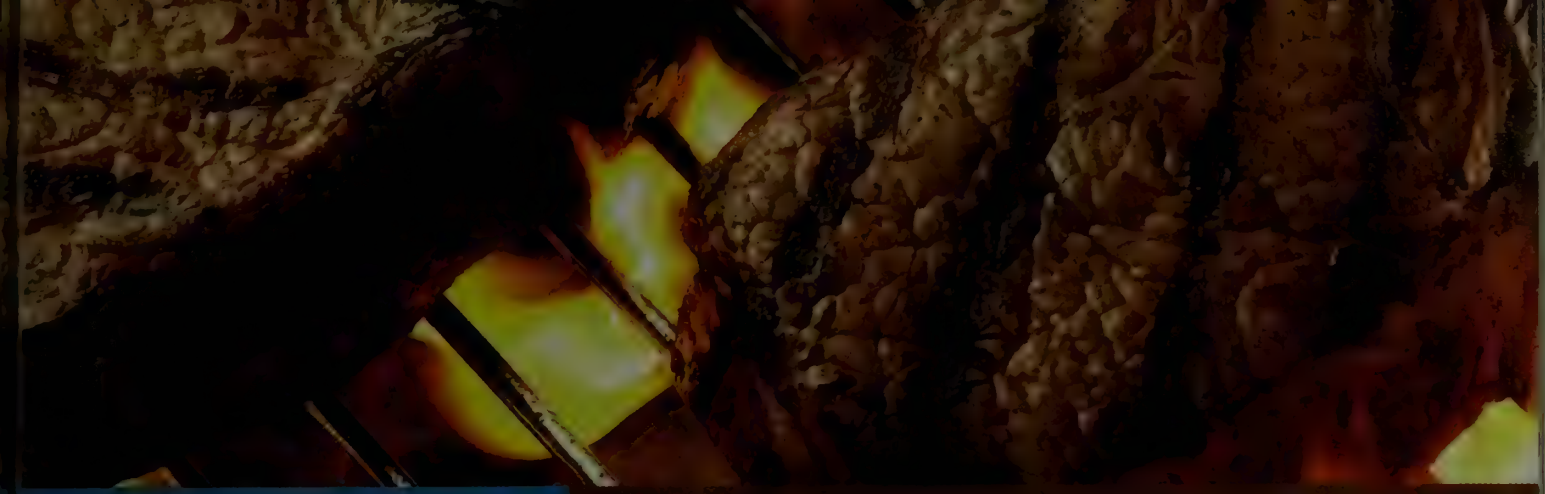

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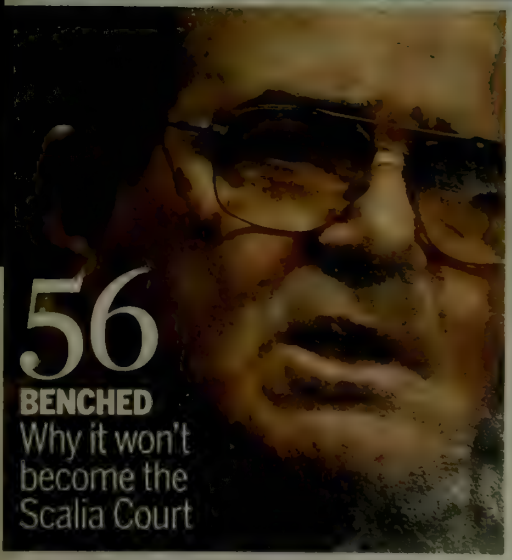

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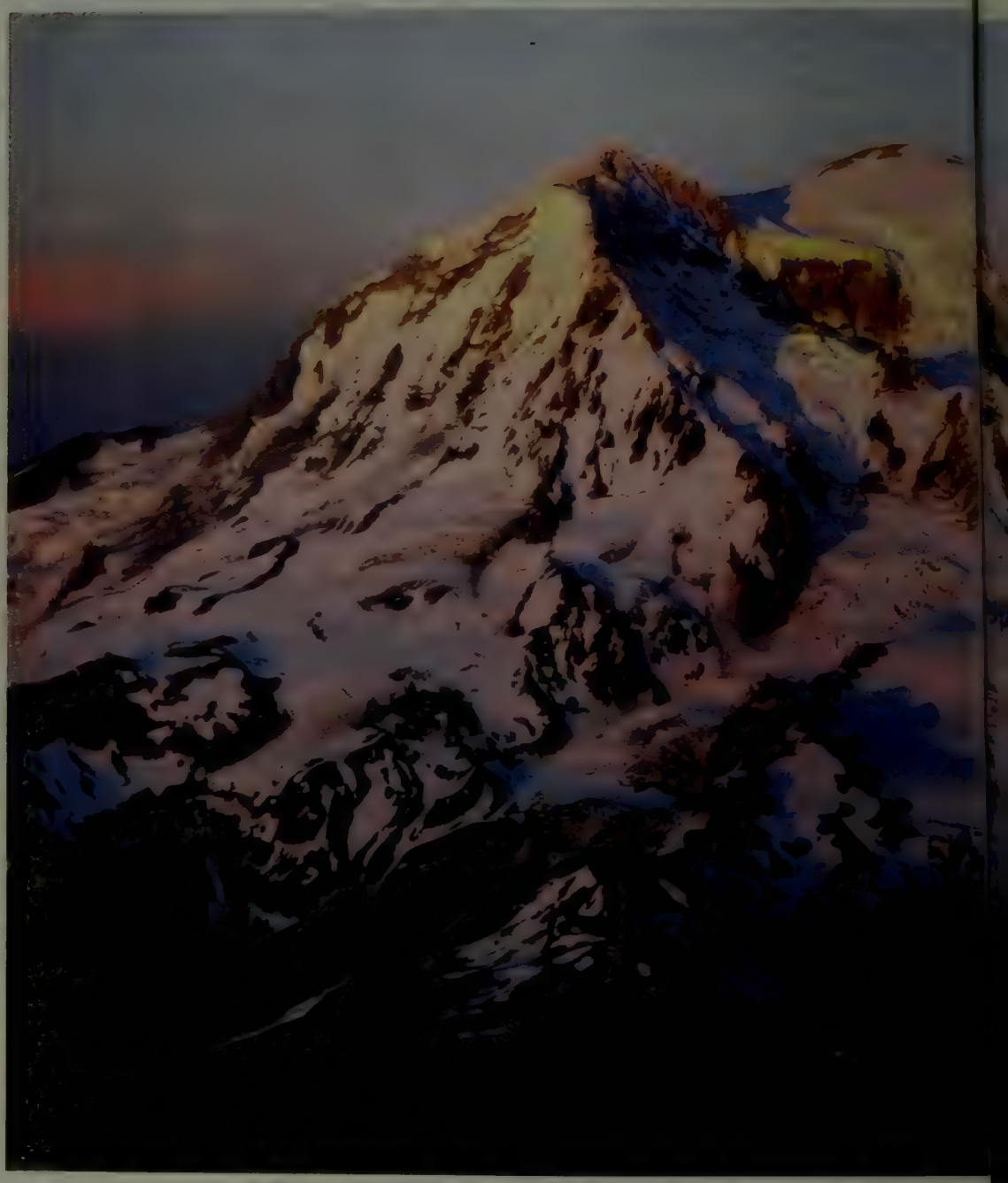

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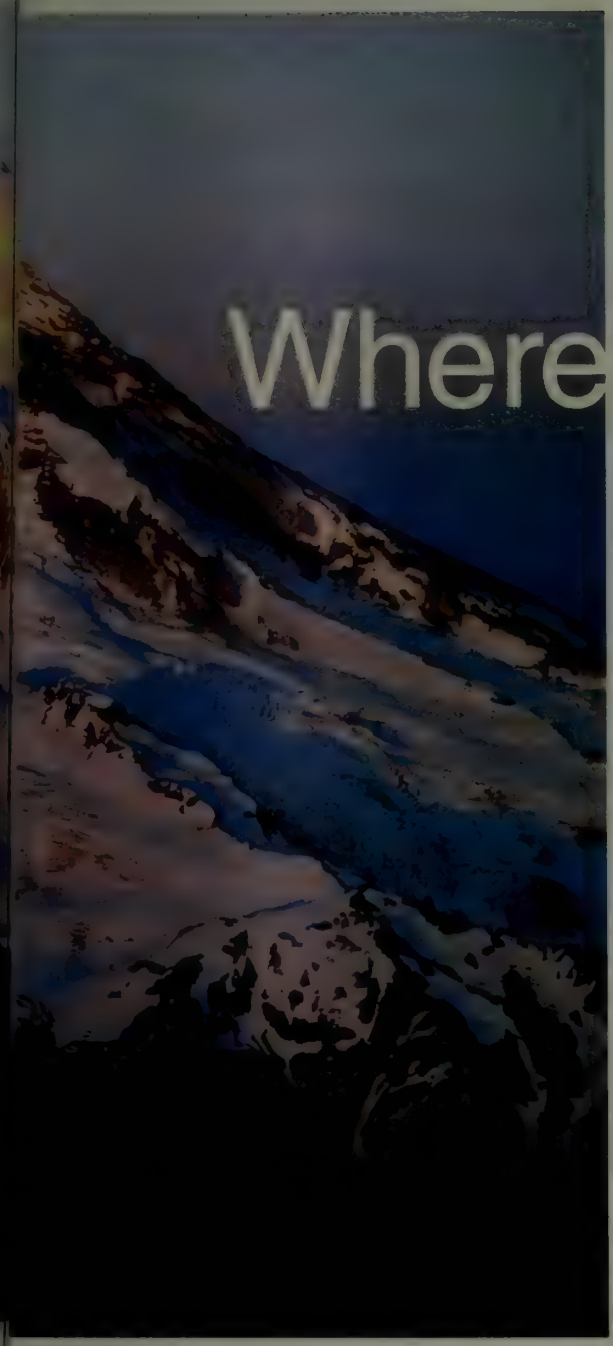

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Special Report: Can Apple Keep Building on the Momentum?

Basking in the runaway success of its iPod digital music player and iTunes Music Store isn't enough for Steve Jobs & Co. because the music labels are growing restless and rival services and players are springing up. So what is Apple doing to keep growing? This **Technology Special Report** looks at its music strategy and more, from its new ROKR music player/cell phone to the possible effects of the **switch to Intel** chips in Macs. Also, **meet some of the designers** who got started at Apple and have gone on to success at all sorts of other companies

HP-Kodak: An Image That Isn't Forming

The computing giant is undergoing a revamp, including a big investment in its own digital imaging business. So rumors that it will buy the film and imaging concern, taking on big risks, don't hold water

Car Buff: Honda's New Civics Lap Detroit

The last of our series on smart cars for college students looks at the '06 Civics, which stand out with appealing design, good handling, and generous safety features. Plus: A slide show with reviews of all our picks

A Happy 10th Birthday For Russian Stocks

A decade after the creation of the Russian Trading System index, the stock market is booming—and its notorious volatility may be smoothing out

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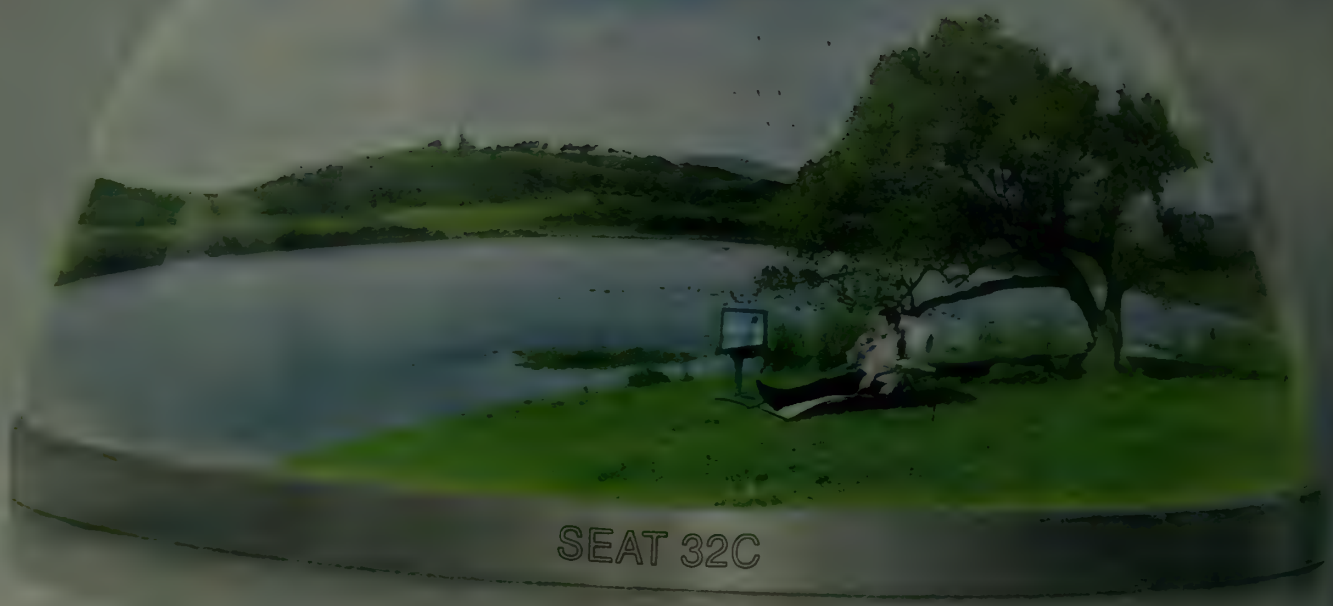

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JP Front

"The world is running out of stupid billionaires."

–GM's Bob Lutz, explaining to the Detroit Free Press *why an ultra-luxury Cadillac would cost less than the $300,000 Maybach*

ITED BY DAN BEUCKE

IRED WORLD

HE REAL COST F A FREE REDIT CHECK

ANKS TO A NEW federal law, llions of consumers are ting a free peek at their dit on www.annualcreditport.com, a Web site set up the major credit bureaus. t they're also scovering that ee" means dging pitches plenty of feesed services. The credit reaus—**Equifax, perian,** and **nsUnion**—were uctant to simply e away products, explains rma Garcia, a senior orney at **Consumers Union.** e result: The site is easy to navigate, yielding a gratis list of current or delinquent loans, credit-card payments, and so on. But the bureaus also are allowed to offer other services. Choose a free report from Equifax, and up pops a chance to pay $6.95 for your credit score. Click "no thanks," and you get two more paid offers. Experian's sell is a bit softer: After getting your report, up come offers for such services as Triple Alert, which lets you know, for $4.95 a month, if someone is probing your credit.

The bottom line? Howard Dvorkin, founder of **Consolidated Credit Counseling Services** in Fort Lauderdale, Fla., says most folks don't need the extras and should stick with the no-charge credit report. *–Lauren Young*

HE BIG PICTURE

ASS THE HAT So far, companies have donated 169 million to Hurricane Katrina relief. But they so sent a range of goods and services. A sample:

Mattel 10,000 toys, mostly African-American Barbies

Disney TVs, DVD players, Disney films to shelters

U-Haul 30 days' free storage to victims

IBM Hundreds of ThinkPad laptops

Kellogg 26 truckloads of cereal, acks, breakfast bars

Starbucks 10,000 lb. of coffee

ta: Company officials

NABBED A vessel bound for China

INDONESIA

Oil Smugglers Buy Low and Sell High

INDONESIAN NAVY PATROL BOATS on Aug. 27 detained a North Korean-flagged ship off the Riau Islands. The *Mount Tioman* was carrying more than 18,000 barrels of oil toward China. It was the latest example of rampant smuggling of oil out of Indonesia, a perverse consequence of that nation's heavy subsidies on petroleum products. Refined products sell in Indonesia for about a quarter of global prices; unleaded gas in Jakarta retails for just 25¢ a liter. Smugglers can make huge profits buying locally and reselling elsewhere. In recent weeks nearly a dozen vessels carrying 80,000 bbl. of gas have been detained, half of them sailing to China or North Korea.

Indonesia was Asia's largest oil exporter until six years ago. Today it is a net importer, and production has fallen from 1.6 million bbl. a day to 970,000. Much of the imported oil leaves as quickly as it arrives. President Susilo Bambang Yudhoyono has vowed to punish smugglers and government officials who collude with them. But analysts have a better solution. "The way to stop smuggling is to remove the root cause: the huge subsidies," says Fauzi Ichsan, an economist at **Standard Chartered Bank** in Jakarta. *–Assif Shameen*

UP Front

WEB WATCH

YOU CAN BET—BUT DON'T CALL IT GAMBLING

A NEW WEB-BASED business, **MoneyGaming.com,** offers high-stakes betting and jackpots to players competing in a variety of online games. Just don't call it gambling. Launched last month, Britain's MoneyGaming is one of a growing number of sites offering so-called games of skill such as chess, backgammon, and eight-ball pool as a legal alternative to online gambling. The general rule under U.S. common law is that contests where the element of skill predominates over chance are considered legal gaming. Those involving more luck than skill, including poker, are classified as gambling.

However, unlike other skill-game sites offering cash prizes, such as **WorldWinner** and **Pogo,** the look of the MoneyGaming site suggests the online equivalent of an upscale casino. Players deposit up to $1,000 and can win as much as $2,000 in multiplayer games. In games like solitaire, they compete for shares of jackpots as high as $5,000. "It appeals to the online gambler and to people who have never gambled online," explains MoneyGaming CEO Liad Shababo. MoneyGaming has about 200,000 registered participants, he says.

While skill-based games may not violate U.S. law, several states have laws that ban the practice or are unclear enough to warrant caution, says Joseph Kelly, a business law professor at the **State University of New York at Buffalo** and co-editor-in-chief of *Gaming Law Review.* (MoneyGaming blocks access in eight states.) And a wild card awaits MoneyGaming back home. A new British law may require the company to obtain a license. Shababo expresses confidence that such a possibility would prove "no hindrance whatsoever."

–Mark Walsh

DANGEROUS DRIVING

WHEN ARMOR HOLDINGS' Centigon unit tested its latest products, they had to survive a roadside bomb blast and a barrage of armor-piercing bullets. Using a new superhard, lightweight steel, the company will upgrade SUVs, sedans, and limos that ferry private contractors and government officials around Iraq and other dangerous places. The price tag: from $100,000 to more than $1 million. Armor Holdings exec Gary Allen says the vehicles will "offer the same protection U.S. military troops are getting" in heavily armored Humvees. It could prove a lucrative niche. "The interest level is huge," says Doug Kennedy, managing partner of Far West Consulting Group. *–Stan Croc*

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FACE TIME

ANDREW WEIL

A HEALTH GURU WITH AN AGENDA

Dr. Andrew Weil wants to show policymakers and health insurers that preventive medicine is worth their investment. Says Weil, "It's cost effective." To prove his point, the alternative-medicine guru, 63, plans to create a hybrid clinic and spa, the Center for Life In Balance, in Catalina, Ariz., that will apply the techniques outlined in his books—from anti-inflammatory diets to medicinal plants —to patients attending the posh Miraval spa. Former AOL chief Steve Case bought a 70% stake in Miraval last February.

Weil, who graduated from Harvard with botany and medical degrees, now practices at the Program in Integrative Medicine at the University of Arizona at Tucson. "Patients get treated there, but then they go down to the cafeteria and eat fast food," he says. He hopes Miraval visitors will take weeklong stays to engage in "integrative healing." His clinic there will collect health data, which he hopes to use to convince insurers that integrative medicine can pay for itself. *–Jessi Hempel*

SMALL BEER

ONLY IN JAPAN: SUDS FOR THE SCOOTER SET

UNDERAGE DRINKING is a problem almost everywhere. That includes Japan, where wine coolers and whiskey can be bought from vending machines. Parental complaints led to a suspension of such sales in that country between 11 p.m. and 5 a.m. and to newer machines that can check IDs. But minors may be getting mixed messages from the growing popularity of a concoction dubbed Kodomo Biru ("kids' beer").

The brew for the younger set, while made of nonalcoholic fruit juice, comes in dark-brown bottles and pours out like a crisp golden lager with a foamy head. The marketing by soft-drink maker **Tomomasu** positions Kodomo Biru as a kind of near-beer so that elementary-school kids and women in their 20s who don't like alcohol can be part of the crowd. The Tomomasu Web site shows snapshots of kids quaffing the stuff with the caption: "For those nights when you want to act a little like an adult."

Originally a novelty when it appeared in southwestern Japan five years ago, the brand has spread to restaurants and stores throughout the country. Tomomasu says it can barely keep up with the demand and expects to ship 1 million bottles this year. The shop owner who invented the product and later allowed Tomomasu to license production says he never intended it to be marketed to children.

Kodomo Biru may not be real beer, but it is priced as a premium brew—a 12-pack gift set (with a complimentary glass mug) goes for about $35. At that price, some kids may decide to stick with plain old soda after all. *–Chester Dawson*

CLASS NOTES

CHINESE STUDENTS GO AULD SCHOOL

MORE CHINESE students are heading to the land of bagpipes and kilts. That coincides with a sharp drop in the number of Chinese studying in the U.S. post-September 11, when visa rules tightened. Chinese coming to U.S. universities are down by 20% since fall, 2001, to 65,000 last year. Meanwhile, Chinese heading for Scotland tripled to 67. Nearly 70% study business, IT, or English for business.

The influx reflects strong business and science programs at **Edinburgh** and **Glasgow** universities. Also, Scotland welcomes foreigners to stay and work for two years after graduating; the U.S. kicks them out if they can't find a corporate sponsor. The drift is slowing: U.S. grad admissions from other countries are off 5% this fall, after a 28% drop last year. But with foreign tuition and fees bringing in $13 billion, that's still big money going elsewhere. *–Sheridan Prasso*

THE STAT

8.7

The average points by which test scores fell for third-graders with TVs in their bedrooms, compared with those without their own televisions

Data: A study of 348 third-graders in six San Mateo County (Calif.) public schools conducted by researchers from Johns Hopkins University and Stanford University Medical School

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"The rise of Chindia'... misses a likely scenario of a global dominating trio of Russia, China, and India."

–Satya Prakash
Whitemarsh, Pa.

CHINA AND INDIA: HOW SHOULD THE U.S. RESPOND?

THE U.S. CAN no longer count on the assumption of more or less automatic leadership in industry and technology ("China & India: What you need to know now," Cover Story, Aug. 22/29). Massachusetts Institute of Technology President Susan Hockfield has said: "We're falling behind, and it's time to think about what we want to be in 20 to 40 years."

One problem is that no one is in charge of doing that thinking. Now might be a good time for Congress and the White House to create a bipartisan commission to make comprehensive recommendations on what must be done to keep America competitive. After all, the direction our economic future will take is just as important as our plans for Homeland Security.

–Clyde Prestowitz
Washington

Editor's note: The writer is the author of *Three Billion New Capitalists: The Great Shift of Wealth and Power to the East.*

THE STATEMENT in "The rise of Chindia" (Editor's Memo, Aug. 22/29) that India, China, and the U.S. will dominate the century misses a likely scenario of a global dominating trio of Russia, China, a India. "Ruchindia" would have all the gredients—land mass, population, he industrial base, technical manpower, domination, nuclear energy, etc.—fo major combine in this century, possi no more than a decade away.

–Satya Prak
Whitemarsh,

I CANNOT accept your conclusion that U.S. will be challenged by China and In any more than we were challenged Germany and Japan after World War rebuilding or by Russia after that. Repr sive and socialistic societies will never s pass the U.S. as long as we don't move far away from the system that has given the greatest economy in the world.

–Dan Schucha
Glen Ellyn,

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ReadersReport

CORRECTIONS & CLARIFICATIONS

In "Wi-Fi with its own Zip Code" (News: Analysis & Commentary, Sept. 5), Hewlett-Packard operates the Wi-Fi system in St. Cloud, Fla. (not Minn.).

"Katrina's wake" (Cover Story, Sept. 12) should have said that Morgan Stanley's Richard B. Berner predicts that the Federal Reserve might pause in raising the federal funds rate at 4%, not that it might stop at that level. And Berner's correct title is chief U.S. economist, not chief economist.

ity, accountability, and contemporaneity.

The often cited city of Bangalore is a cynical example of politicians and bureaucrats focused primarily on milking the opportunities created by world-beating private-sector standards for their own self-enrichment. Meanwhile, the city itself is sinking in a morass of crumbling infrastructure and bumbling autocracy. Almost all civic systems are in gridlock, and the same corporations that built the city's reputation are now seeking ways of escaping it in their own development plans. That's a cop-out that ill serves this country's needs of the future.

–Stanley Pinto
Bangalore, India

I HAVE been working with various Chinese companies for more than six years . I was particularly glad to read your discussion about the lack of management talent in China. I have found that Chinese workers are eager to learn and generally smart enough, but because of the education system, which encourages memorization vs. creativity, it is difficult for them to understand that they are in charge—that they are expected to develop the plan for execution vs. following a repeatable concept. Given this dilemma, China seeks assistance with training of their upper and middle managers in Chinese-run companies.

–Vela McClam Mitchell
Smyrna, Ga.

BOTH CHINA AND India lack the managerial expertise for global collaborative enterprises. As China creates the demand for 75,000 executives with international experience, we must work on tooling our workforce to take a lion's share of these leadership positions. In the past two decades, U.S. educational institutions and corporations have made major strides in increasing international exposure to our workforce. We currently have the understanding, the global people and technology network, and the investme infrastructure to define, design, and bu the engines for global collaboration. T economic value lies not within the fac ries, but within the business models Amazon.com and Dell.

–Arvind Sa
Vienna,

YOU SUGGEST that schooling in m and science as well as foreign languag especially Chinese, are two areas requ ing the most attention ("What Amer must do to compete with China and dia," Editorials, Aug. 22/29). I sugg that the real key to achieving this goa to greatly expand the employment opp tunities and salaries of engineers and s entists who speak foreign languages.

I know many young electrical en neers and computer scientists who gra uated from good schools and speak re sonable Chinese but could not find jo Consequently, almost all my Asian Am ican friends encourage their children study either law or medicine (for an M. not biological research). Believe me, most all of these young Asian America are very good in math and science.

–Yuh-hwang Ts
Houst

IN YOUR LEAD story you encourage yo readers, after visiting China, to "hop o plane to India." I need to travel from B jing to New Delhi next month. My only c tion for a nonstop flight: Ethiopian A lines, I was surprised to find out, and tha only three times a week. (China Eastern fers a connection, but via Shanghai arr ing into Delhi in the middle of the night

–Duncan Clark, Managing Direct
BDA (China) L.
Beiji

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Amgen's Giant

AS PART OF HIS battle against kidney disease, George Rathmann receives a dose of Epogen almost every day. He revels in the ritual, and not just because the drug helps him fight the anemia caused by his dialysis treatments. Rathmann's satisfaction stems from his very personal role in getting Epogen to market at Amgen Inc., the biotech giant he co-founded in 1980. An engineered form of a human protein that stimulates red blood cell production, Epogen was one of the world's first biotech blockbusters, surpassing $1 billion in annual sales in 1996.

Amgen, which turns 25 this year, didn't invent the technology that turns human proteins into drugs—rather, it built on discoveries made in academia. But Rathmann did teach the industry how to turn lab breakthroughs into billion-dollar products. And even as he struggles with illness, Rathmann is still helping to get biotech startups off the ground.

A charismatic chemist with a penchant for business, Rathmann was working at Abbott Laboratories in the mid-1970s when biotech pioneers perfected the technique of splicing DNA from one organism into the genome of another. The technology piqued the interest of many drugmakers, including Abbott. But executives were so fearful of the unproven science that they isolated the new research teams in ultra-secure labs. At Abbott, for example, any scientist who missed a day of work had to undergo a thorough physical exam before returning to the lab.

Rathmann feared the overprotective approach would suffocate discovery. So when venture capitalists and a scientist friend approached him in 1980 and asked him to help start a company called Applied Molecular Genetics Inc., he jumped at the opportunity. The Thousand Oaks (Calif.) startup, later renamed Amgen, sat in a concrete building partially occupied by an evangelical choir. It was a step down from Abbott, but to Rathmann it was the perfect setting for scientists to seek out new therapies without restrictions. "At Amgen, you could leave your lab door open," he recalls.

Born in Milwaukee, Rathmann was turned on to science by his older brother and brother-in-law, both chemists. After earning a PhD in physical chemistry from Princeton University, he joined 3M in 1952. Rathmann worked his way through the ranks, leading such projects as 3M's entry into U.S. market for X-ray film. In 1975 he joined Abbott, where h eventually became vice-president for R&D.

George Rathmann guided one of biotech's first blockbusters

At Amgen, Rathmann's mastery of both science and finance helped him spot opportunities. In 1984, shortly after an Amgen scientist cloned the gene to make Epogen, Rathmann got a call from Kirin Brewery Co., Japan's largest beermaker. Kir offered to lend its fermentation expertise to Amgen's manufacturing process in return f joint commercialization rights. Despite the unlikely pairing of beer and biotech, Rathmann struck a deal that secured $12 million in much-needed funding. "We could see our last dollar," says current CEO Kevin Sharer. The Kirin partnersh "is key to our history." In 1983, Rathmann led Amgen through a $42 million initial public offering.

In 1989 the U.S. Food & Drug Administration approved Epogen. The drug and related anemia remedies now bring more than $8 billion a year in sales. Amgen remains the world's largest biotech, with annual revenues of $10.6 billic and a market value of $101.5 billion—larger than Abbott's.

Rathmann retired in 1990. At 77, he consults for biotech startups, encouraging the study of stem cells and other new technologies. Could stem cells solve the most confounding ills? "Heavens, yes," says Rathmann. "It's the master cell."

–By Arlene Weintr

BusinessWeek online For an interview with Amgen founder Georg Rathmann, go to businessweek.com/extras

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BY STEPHEN H. WILDSTROM

Kinder, Gentler Cell Phones

An Aug. 15 column on special mobile phones for young children ("Cell phones for the sand lot") drew an emotional response from some readers. There seem to be a lot of people whose needs are not being met by existing wireless offerings, including the elderly, the disabled, and folks who just want an easier way to make and receive calls.

"Basically, I want to be able to make an emergency call simply and reliably," wrote Katherine H. Long of Boerne, Tex. "I would gladly pay a premium for a phone that was not cluttered with functions I do not want. In a true emergency, seconds count, the light may be poor, and emotions affect using the phone."

Many factors share the blame for cell phones' increasing complexity. Faced with a stagnant market for voice calls, wireless carriers have looked for growth by pushing data services such as photo transfers and e-mail. Handset makers have obliged with a race for new features, requiring additional buttons and screen menus even as the phones themselves shrink. And the carriers, like TV advertisers, worship the youth market and have shown little interest in customers who want a minimal service plan and plain handset to make an occasional call.

For those whose physical or mental disabilities preclude the use of a standard handset, the Firefly from Firefly Mobile might be the best bet—because two big buttons that can be programmed to dial numbers make it very easy to use. But adults may not much like the Firefly's brightly colored case or flashing lights. That presents an opportunity for service providers and cell-phone companies to come up with a Firefly-like handset with big, easy-to-see buttons that would be especially helpful to elderly people suffering from arthritis, poor vision, or cognitive impairment.

IF YOU ARE HELPING AN AGED RELATIVE or friend find the right phone, keep in mind that even a handset with no service must be capable of placing a 911 call. So you might pass along an old handset—or you can put your friend in touch with Phones for Life, which makes donated phones available free of charge to the disabled and elderly. One catch: These handsets don't always make it easy to dial an emergency call. If that's a problem, consider the SafeGuardian from Clayton Communications, an emergency-only phone with a big red 911 button. But the price, $39.95 a month with a one-year contract, is steep for such a limited function.

Many middle-aged customers without any particular disabilities seem frustrated by their mobile-phone choices. "Even for those of us with normal mental functioning, it can be very difficult to parse the bells and whistles on newer cell phones," wrote Aline Henderson of Washington, D.C. "I carry a cell just for emergencies. And at age 54, I find it hard to read small text on tiny buttons."

Carriers cater to youth—but the elderly need simpler handsets

Phone companies in Europe and Japan take such input seriously. Vodafone, Europe's largest carrier, offers two models called Simply, from French handset maker Sagem. They feature limited functions (just voice calls and text messaging), big buttons, and a large, easy-read screen. TU-KA Cellular, a subsidiary of Japan's KDDI, offers a model that looks more like a typical cordless phone with a big dial pad.

For now, however, no U.S. carrier has announced plans for simplified phones. So if you desire something less complicated and models like the Firefly aren't appealing, you should probably look at giveaway or low-cost phones that are included with service plans. They are generally bigger and simpler than the more expensive models. Bar-type handsets often have bigger and easier-to-use buttons than flip phones. But these still fall short of what many people desire.

There is an underserved market out there for simplicity. I can only wonder why wireless carriers hungry for growth haven't leapt at the chance to give customers what they want.

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BY JON FINE

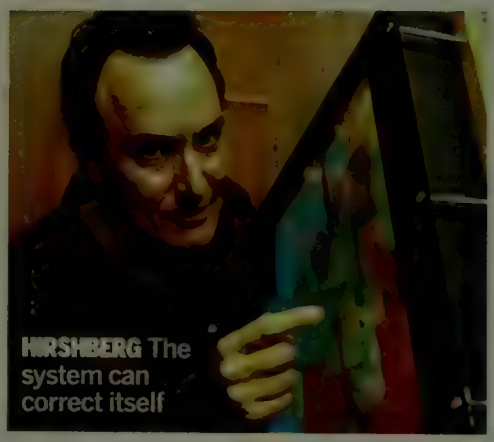
Media, Marketing, and Advertising in the 21st Century

Remapping the Blogosphere

How excited is Peter Hirshberg, Technorati's executive vice-president, about his site's new toy? We're at a birthday party—music playing, cocktails flowing, women in slinky dresses—and he drags me over to a laptop to show off a beta version of Technorati's new searchable blog directory. ¶ Did I mention it's Hirshberg's birthday party? Because it is.

Wait. Here comes the cake. The demo is briefly suspended.

Technorati Inc., launched less than three years ago, is one of several sites seeking to overlay organizing principles upon the fast-growing tendrils of the blogosphere. Until now a Technorati search for "goldfish" spat out a series of recent blog posts that mention goldfish, regardless of what the blog actually focuses on. The new search allows users to search blogs by subject matter. This is a simple and obvious function, but one not broadly available until now. It's also sorely needed, given the volume of blogs out there. As Technorati founder and CEO David L. Sifry often says, a new blog is created almost every second, and the total number of blogs doubles around every 5½ months.



HIRSHBERG The system can correct itself

What's happening with blogs is another example of how rapidly advances can become second nature to early adopters while remaining obscure to the general public. In certain circles, blogs such as Wonkette and Engadget are core information sources (as well as passwords to semi-closed worlds of insiders); in others, mentioning them garners blank stares. But this exclusivity is precisely the appeal for advertisers seeking to wed tightly targeted messages to niche audiences.

WHILE BLUE-CHIP ADVERTISERS such as Dell and Audi have embraced blogs, many Web-savvy marketing executives—even at companies with names that imply gobs of hip cachet—privately express frustration over higher-ups' slowness to recognize a new ad medium. Technorati's blog directory, which was launched on Sept. 2, represents a stepped-up effort to make the blogosphere more accessible to outsiders, be they clueless advertisers or newbie readers. "Consumers are finding blogs and using them as research tools, but they're having trouble navigating the space," says Shawn Gold, publisher of Weblogs Inc., which runs Engadget and more than 80 other blogs.

Technorati's search database will harness the collective smarts of a critical mass of engaged users. (Web communities from eBay to open-source encyclopedia Wikipedia have develop formidable stores of knowledge in thi fashion.) It begins with bloggers tagging their sites by topics of interes Lest omnivorous bloggers try to gam the system and claim they cover subjects they rarely write about, they can declare expertise in only 20 subjects, and a feedback mechanism lets users suggest that blogs be removed from certain categories. Because Technorati scans 16.4 millior blogs, all it takes is those bloggers spending a few minutes with th database "for the entire system [to] get smart and correct itsel very quickly," says Hirshberg.

Technorati's directory would help readers—and advertisers

Technorati's effort gives it first-mover advantage. IntelliSeek Inc.'s BlogPulse has similar product, but it's availab only to paying clients, says Chi Technology Officer Sundar Kadayam. And Technorati mad another recent move to raise its profile among the non-cognoscenti: Its links to relevant blo posts now appear alongside articles on *Newsweek*'s and the *Washington Post*'s sites.

Technorati's focus on making the blog world bite-sized fo a more mainstream audience comes as it takes heat from bloggers complaining about spotty searches and sluggish technology. ("We made a mistake. We didn't anticipate the growth," says Sifry, who promises that infrastructure improvements are on the way.) The initiatives also help protect against the warp-speed of competition in cyberspace Consider another early mover in a hotly competitive Web space that, after a strong debut, lost big to an upstart after failing to give its users more. Technorati, meet first mover Friendster, and newcomer MySpace. ■

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The Barker Portfolio

BY ROBERT BARKER

Applebee's Looks Appetizing

Way, way down the list of woes left by Hurricane Katrina was the temporary closure of 15 Applebee's restaurants. Just the same, the distraction hardly could have come at a worse moment for this casual-dining chain, which only days before warned investors of slowing profit growth.

The economic uncertainty brought by Katrina helped push shares of Applebee's International below 22, down from over 29 in March and to a level not seen in almost two years. This is only the latest trouble for the Overland Park (Kan.) chain of Applebee's Neighborhood Grill & Bars, which long had delighted growth-stock investors with regular advances in same-store sales. Then, early this year, Applebee's first noticed a faint sputtering. For example, fewer customers were ordering dessert. More were choosing to drink plain water instead of soda. Sales in some regions, first the Midwest and then New England, were softening, too. By August, Applebee's saw customer traffic decline by 4% at company owned stores. Its main clients—those in households with annual incomes of $50,000 to $70,000—were cutting back on dining out, the company figured, as gasoline prices dug deeper into budgets. With that, and a belief that higher gas prices will be with us for a while, Applebee's warned that earnings per share this year would grow only by 5% or so—if at all.

YET AFTER LOOKING at the company's financial position, patient investors may find that the stock near 22 offers a reasonable opportunity. For starters, the company's balance sheet is strong. Total debt comes to $87 million, or less than 15% of total capital. The median debt-to-capital ratio for comparable companies is 31%, according to Capital IQ, a unit of Standard & Poor's. The company's strategy of partnering with franchisees for nearly three-quarters of its 1,745 units means it enjoys sharply wider margins than many rival restaurateurs (table). Applebee's gets 4% off the top of sales at franchised locations, so any uptick in sales makes its way swiftly to the bottom line. Steven Lumpkin, the company's chief financial officer, told me that these royalties translate into cash flow of some $130 million this year.

NEW TACK The chain plans to roll out a "value" ad campaign

That liquidity has helped to keep Applebee's balance sheet lean while fueling growth. In 2003 the company opened 100 restaurants, last year it brought on 109 more, and this year it's set to open at least 135 new units. Lumpkin said that next year's number of openings should be higher still, with an ultimate goal of at least 3,000 U.S. locations and another 1,000 abroad, where 63 Applebee's are now found in 12 countries.

In the meantime, there's the problem of driving traffic back into the restaurants. Lumpkin told me that Applebee's is preparing to roll out a marketing campaign stressing a "value message." He was vague about specific details, but that could translate into reminding consumers of Applebee's relatively low prices—the average check runs about $10.50—or of inviting them back with specials at slower times of the week, such as during lunchtimes on Mondays and Tuesdays.

Rival restaurant chains are responding to the slowdown in middle-class consumer spending similarly, so fresh marketing won't yield magic results. What will help investors is the simple passage of time. Applebee's year-over-year sales comparisons this summer were made difficult by a surge last year when it introduced a menu designed in partnership with Weight Watchers International. Same-store sales might start improving by yearend, Lumpkin told me, with clearly better comparisons a fair bet by next spring. Applebee's trades at 15 times the next 12 months' earnings, in line with the broad market and its rivals. Priced, in other words, to rise on any pickup in demand. ■

E-mail: rb@businessweek.com

Applebee's: Underappreciated?

COMPANY (SYMBOL)	NET PROFIT MARGIN	PRICE-EARNINGS RATIO*
Applebee's International (APPB)	9.6%	14.9
Brinker International (EAT)	4.1	14.8
Cheesecake Factory (CAKE)	7.0	25.9
Darden Restaurants (DRI)	5.5	14.9
Outback Steakhouse (OSI)	4.6	15.4

*Based on next 12 months' earnings

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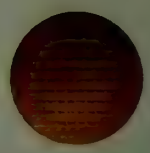

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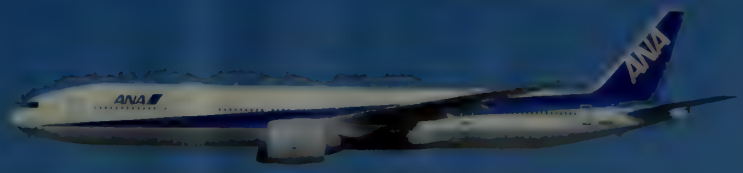

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/ JAMES C. COOPER & KATHLEEN MADIGAN

Katrina's Impact Depends On How Business Reacts

oss of confidence could be just as dangerous as higher energy costs

U.S. ECONOMY To a great extent, Katrina has rendered useless uch of the economic data due out in coming weeks. But the reports ill have value in one critical way: They should generally show that verall growth prior to the hurricane had a great deal of momentum, specially in the labor markets—a factor that will help the economy

ather the storm's impact.

Typically, a hurricane is not easy to spot in the national ta. A storm affects only a small area of the U.S., and sinesses reopen and people get back to work within the e it takes to tot up a quarter's gross domestic product. st hits to monthly industrial output and payrolls that d been discernible were often swallowed up by broader nomic trends after a month or so.

This time is different. Because Katrina hit America's me energy corridor, she brought with her a veil of certainty. Businesses and households must weigh the ults of curtailed oil and gasoline output. They must o consider the broader economic drag possible from pping disruptions and product shortages.

Most important, the question of future energy prices ms large. Fortunately, refinery damage looks limited, restoration of electric power to healthy refineries is der way, and the two big pipelines that carry gas and er petroleum products from Houston to New York are eady back to operating near full capacity.

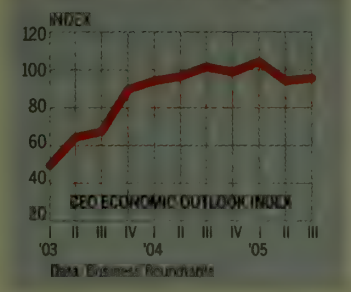
What's more, worries about gas shortages are easing. e futures price for wholesale gas has dropped 30% m its panicky high of $2.92 a gallon on Aug. 31, down $2.02 on Sept. 7. That's close to pre-Katrina levels, ggesting the spike in retail prices should be short-lived. fact, the current wholesale price implies pump prices ld fall back to around $2.67 a gallon nationally.

The better news on energy may be causing financial rkets to reassess Katrina's effect on economic activity. th prospects improving, stock prices rebounded ongly on Sept. 6, and the yield on a 10-year Treasury te rose to 4.09%, the largest one-day rise in a month.

ILL, POST-DISASTER UNCERTAINTY could have its gest influence on the business sector, where nfidence in the economic outlook is crucial to plans for rything from equipment spending to inventory cking to hiring. Any shifts in attitude and decision-king in the boardroom could adversely affect the ader economy beyond Katrina's direct impact.

That's why the readings on pre-Katrina business nfidence are so important. The Business Roundtable's st survey of CEOs shows optimism up a bit before the hurricane and holding at a high level (chart). Indeed, 83% of CEOs expected sales to keep rising, 54% expected to lift their capital spending, and 76% planned to either expand payrolls or hold them at current levels. Moreover, Roundtable Chairman Hank McKinnell noted that "the strength in the economy's fundamentals just prior to the disaster may prove to cushion its full impact."

CEO OPTIMISM HOLDS AT A HIGH LEVEL



Any pullback by businesses, especially on hiring, would make it that much tougher for consumers to handle surging energy costs. If average gas prices stay at $3 per gallon by the end of September, from $2.22 at the end of June, that 35% increase would cost households an extra $93 billion. Measured at an annual rate, that's enough to soak up 4.1 percentage points of any expected gain in aftertax income during the same three-month period. Existing savings and new borrowing, supported by past wealth gains from rising home values, will provide some offset, but consumer spending will take a big hit in coming months, just as retailers are gearing up for the important holiday shopping season.

How big? Although consumer purchases and overall GDP growth in the third quarter will be affected to some degree by Katrina's aftermath, the bulk of the impact will most likely be concentrated in the fourth quarter. Higher gas prices alone could cut growth in fourth-quarter consumer outlays by some 1.5 to 2 percentage points from what it would have been if pump prices had held at July levels. The Congressional Budget Office estimates that Katrina could shave 0.5 to 1 percentage point from overall economic growth in the second half.

SO FAR SOLID JOB GROWTH has ameliorated the blow to consumers from higher fuel costs. Nonfarm businesses expanded their August payrolls by 169,000 workers, and the Labor Dept. said its count of June and July jobs was

44,000 higher than its first estimate. That brought average monthly job gains in July and August to 205,500, slightly above the the pace for the entire year (chart). It was fast enough to keep shrinking the unemployment rate, which dipped to a four-year low of 4.9% in August.

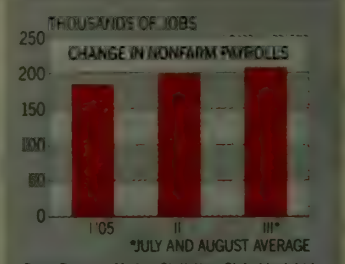
The continued tightening in labor market conditions runs in line with the recent downshift in new jobless claims and the upbeat view of job markets seen in the Conference Board's survey of consumer confidence. Of course, given the extended business closings in the wake of Katrina, the September employment report could very well show an outright drop in jobs nationwide, and the jobless rate could pop back up above 5%.

But what will matter more is how much jobs bounce back in October. A rebound in employment this autumn will be determined in part by how quickly the rebuilding effort begins. Congress approved President George Bush's request for $10.5 billion in emergency aid to the area and another $51.8 billion was requested on Sept. 7. But job growth will depend greatly on Corporate America's perception about this expansion's strength in the wake of the hurricane.

ALSO IMPORTANT, Katrina will be very much on the minds of Federal Reserve officials when they meet to set monetary policy on Sept. 20. Several Fed watchers now think the Fed will pause in its 16-month-long strategy of raising short-term interest rates, if not at the next meeting, then later in the year.

However, Katrina threatens to cut the economy two ways. Besides being wary of the drag on growth, policymakers will also be concerned that higher energy costs are pumping up the prices of other goods and services. In this regard, the post-Katrina rally in the bond market, which pushed the yield on a 10-year bond down 4.02% in late August, seemed overblown. Bond traders appeared to be focusing solely on the growth impact rather than on t Fed's pre-hurricane wo about pass-through effe from costlier energy.

BEFORE THE HURRICANE, HIRING WAS STRONG



Data: Bureau of Labor Statistics, Global Insight Inc.

After the September meeting, a Fed respite i likely only if disruption shipping and energy ar long-lasting. Fed Chairman Alan Greenspan met with Bu and Treasury Secretary John W. Snow on Sept. 8 to discuss the economy and Katrina. Afterward, Snow said the chairman shared his view that the effects will most likely be temporary.

The experience of recent years shows that it's easy fo shock to knock a weak economy for a loop. But a healt one is a lot more resilient. Unless business sentiment takes a lasting turn for the worse, and $3.50 gas hangs around a long while, all the latest signs indicate that today's economy remains strong enough to take Katrin blow and keep chugging ahead. ■

AUSTRALIA

Slowly Letting the Air Out of the Bubble

THE RESERVE BANK of Australia is seeing the start of a consumer soft landing, helped in part by a cooling housing market. Policymakers from the U.S. to Europe, who are dealing with their own hot housing sectors, want to see if the RBA has succeeded in deflating its housing bubble without wrecking the economy.

Real gross domestic product grew by a larger-than-expected 1.3% in the second quarter, after a revised 0.5% gain in the first. Business investment powered the second quarter advance, while consumer spending was lackluster.

Slower consumer demand is why real GDP is expected to grow well below 1% in the second half. Households are feeling the brunt of rising energy costs and leveling home prices. The cost of a gallon of gasoline in Australia now averages $1.21 per liter (U.S. $3.51 per gallon), a jump of 27% since the beginning of the year.

SECOND-QUARTER GROWTH: THE LAST HURRAH?

Bloomberg Financial Markets

At the same time, past interest-rate increases by the RBA have deflated the housing market at a rapid clip. In the second quarter, home prices in major cities were down 0.1% from year-ago levels. That followed three years of double-digit gains. With budgets under stress, consumers cut back on shopping and borrowing in July.

What worries analysts is how low home prices could go. A sharp drop could upset consumers and trigger a pullback in demand. So far, solid labor markets have offset housing's drag. In July the jobless rate was a low 5%, with 12,700 jobs added.

For now the business sector seer ready to pick up some of the slack. Second-quarter business investme jumped 6.8%, and the amount expected to be spent over the next year is larger now than in the projections of the first quarter.

Global demand for raw material prompting commodity producers a exporters to boost their capital investment. However, the drop in consumer demand is falling back o the manufacturing sector. Factory production and orders fell in Augu

The slowdown in demand is eas upward pressure on inflation and lessening the need for more interes rate hikes. The RBA did the expecte on Sept. 7 and left its cash target ra unchanged at 5.5%. Analysts anticipate monetary policy to rema on hold well into 2006. ■

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An American flag, torn by Hurricane Katrina, flies over the University of Alabama in Tuscaloosa on Aug. 30, 2005

O IN THIS SECTION:
6 Managing in the middle of Katrina
52 When retailers can be mistaken for profiteers
56 The horse sense of skipping over Scalia
58 Steve Jobs's cell-phone gambit

THE NEXT BIG ONE

Where America is most vulnerable and how the nation can better manage the risks ahead.

BY BRUCE NUSSBAUM

DR. IRWIN E. REDLENER IS IN Baton Rouge, La., setting up mobile medical units. He has been in Louisiana and Mississippi for many long days helping people deal with the horror of Hurricane Katrina, and his voice is full of anger and despair. "The country is really just not prepared for a major catastrophic event," says the director of the National Center for Disaster Preparedness at Columbia University's Mailman School of Public Health. "Whatever it is—the Big One in San Francisco, a terrorist attack—it doesn't matter. The unfortunate truth is our ability to imagine and plan for catastrophic disasters is woefully inadequate."

DANA MIXER/BLOOMBERG NEWS

For the moment, the nation's economy appears to have dodged the disaster bullet. Repairs to refineries and pipelines are under way, gas prices are coming down, and overall growth continues to be strong. With government and private funds pouring into Louisiana, Mississippi, and Alabama, that region should recover over time. The same can't be said of relations between Washington and state and local officials who are still battling over responsibility for the flooding and looting in New Orleans. As criticism over the slow federal response rose like the area's floodwaters, the White House responded with leaked reports of local bumbling. That had Democratic Senator Mary Landrieu of Louisiana fuming on ABC-TV's *This Week* that "if one person criticizes our sheriffs or says one more thing—including the President of the United States—I might likely have to punch him. Literally."

Yet, the political recriminations show that even as we approach the fourth anniversary of the September 11 terrorist attacks, the nation remains divided on what to do when terrible things happen. We still have difficulty grasping the notion that we are not safe from disaster in our own country. We couldn't imagine a foreign terrorist attack on our soil. It happened. We couldn't imagine an entire city disappearing under water, its population evacuated—but too late. It happened. We must begin to imagine future disasters, perhaps multiple catastrophes, for they, too, may well occur. It is no accident that this is precisely the conclusion that the 9-11 Commission reached in analyzing the attacks on the World Trade Center and the Pentagon. "The most important failure was one of imagination," it said.

However much we want to believe it, New York and New Orleans are not unique events. The Next Big One is almost certain to come, and soon, perhaps in the form of an earthquake in California (page 38), an avian flu pandemic starting in Chicago (page 40), or a dirty bomb in Washington or Manhattan (page 42). Homeland security experts have identified a wide range of grave risks.

We know this because an enormous amount of information flowing through our political and civil organizations already reveals these risks—just as data existed to foretell the New Orleans and New York disasters. In these two events and in others (the Challenger and Columbia shuttle accidents and the breakdown of the electric grid in the summer blackout of 2003), the issue wasn't information. Problems emerged because of deeply flawed organizations beset by poor management, siloed cultures, and inadequate communication. People could not deal with what they believed to be remote, low-probability, high-risk catastrophes even when confronted with irrefutable data.

In the business world, disruptive innovations and events occur frequently. CEOs and companies get blindsided for the same reasons. The Internet, China, startups, and surging oil pr are just some of the surprises in recent years. But the co quences of these kinds of shocks are limited to a hit to the tom line, unemployment, and falling share prices. The st during a terrorist attack or natural disaster are vastly high

There's no way to be sure, but a confluence of trends app to be raising the frequency, magnitude, and costs of many k risks. Global integration is bringing everything and everyt closer faster, from technology to terrorists, visitors to viru

Will Katrina Rob Our Future?

Gauging the Impact A special report on the devastating human toll—and the damage to America's energy infrastructure—that could reverberate far into the future

The Coming Economic Downshift Katrina will cut into third- and fourth-quarter GDP growth

Business Comes to the Aid The outpouring of contributions is so strong that American companies are on track to outstrip September 11 and tsunami donations

BusinessWeek online

www.businessweek.com/go/katrina/

Sleepless Nights

TERRORISM	THREAT
NUCLEAR BOMB	The Homeland Security Dept.'s biggest stolen or homemade nuke explodes in U.S. city. A shipping container, truck, o small boat could carry such a weapon
BIOLOGICAL ATTACK	Terrorists could disperse smallpox, Eb other germs in a subway station or airp let travelers spread an epidemic world
CHEMICAL ATTACK	A bomb at a chemical facility—many o are located in highly populated areas— create a Bhopal-like poisonous plume.
DIRTY BOMB	A conventional bomb can spew radioa material gathered from medical or pov wastes and contaminate a large urban
COORDINATED ATTACKS	Simultaneous terror attacks on multip targets could overwhelm emergency re and communications systems.
NATURAL DISASTERS	
CATEGORY 4 OR 5 HURRICANE	Huge storms in the Atlantic and the Gu Mexico can pack 200-mph winds and foot storm surges onto shore.
EARTHQUAKE	The Big One could collapse buildings, i fires, create a tsunami, and destroy ro rail lines needed for rescue and relief.
FIRESTORM	A city set ablaze, intentionally or via a gas pipeline break or chemical fire, cou create a holocaust of flame, smoke, an superheated gases.
MEDICAL DISASTERS	
PANDEMIC	A mutated flu virus could spread arour world for months before a vaccine coul up.
RADIATION LEAK	Coolant loss at a nuclear power plant c send a radioactive cloud over nearby c

tential proliferation of small biological, nuclear, and chemi- weapons is making security more difficult. Whatever the ıse, the earth is warming, making much of the weather more ocious. The U.S. appears vulnerable today to a growing num- of potential disasters. Avian flu alone threatens to kill mil- ns. It's a scenario people find difficult to absorb, let alone act . Yet even though any one disaster is unlikely, the growing mber of possible catastrophes raises the likelihood that at st one of them will strike.

eland security and disaster planners worry about these 10 risks to America

OTS	TOLL
k, Washington, ports Boston, Seattle, Los	In a densely populated city, 100,000 lives could be lost. Property damage and economic harm could top $1 trillion.
centrated area release would hundreds	An attack on one city could cost $750 billion and claim 1 million lives—more if the disease spreads.
sey, Houston, ıa; chlorine tank cars near the Capitol	More than 700 chemical plants are located where 100,000 or more live. Economic damage would run in the billions.
k, Chicago, phia—any large, ıty	Immediate deaths in the hundreds; long-term cancer deaths in the thousands. Economic damage depends on radioactivity. Some areas could be uninhabitable for years—or decades.
, rail systems, big	Would depend on number and type of targets. Multiple successes would exponentially increase the death toll and cost.
ast from Florida to ast Coast from o Long Island	Hurricane Katrina is estimated to have caused thousands of deaths and cost up to $200 billion, not counting the economic impact of rising energy prices.
ia, Alaska, and the t's long-dormant New fault	A magnitude 7 quake would kill up to 8,000 in L.A. and cost up to $250 billion. The Bay Area could suffer 6,000 deaths and tens of billions in damages.
minals in Boston and ville, Fla.; New ports of Los Angeles mington	Thousands of lives and tens of millions of dollars.
	The Spanish Influenza, 1918-19, killed between 20 and 50 million; the 2002 SARS outbreak from China cost the world economy $30 billion.
oint, just 35 miles of NYC; Turkey Point, ounty	As many as 44,000 immediate deaths; upwards of 500,000 could eventually die from cancer.

and Security Dept.; Brookings Institution; World Health Organization; CIA; Union of Concerned Scientists, U.S. Geological Survey

The good news is that preparing for one disaster prepares for all of them. Planning relies on the same infrastructure and organizations. People are reluctant to pay to prepare for an unlikely event that may happen once in a lifetime. Paying for the possibility of a series of different unlikely events seems to make even less sense. A new approach to both terrorist and natural disasters may work better: Allow cities to deal with all contingencies at once by using the same infrastructure. Pioneered by the State University of New York at Buffalo's Multidisciplinary Center for Earthquake Engineering Research, this approach to multiple hazards is being used in California to "enhance the resilience of the critical infrastructure that communities will need," says director Michel Bruneau. "The three most important things are power and water, acute-care facilities like hospitals, and response-and-recovery capabilities." Strengthen these three, and you are better prepared to deal with almost all eventualities.

Here is what should be done to manage the nation's risks and prepare for the worst.

» PAY FOR REDUNDANCY We live in a private, hyper-efficient, just-in-time economy with no slack built into it. But dealing with catastrophe requires just the opposite—extra capacity and backup. Cell-phone communications failed in both New York and New Orleans in part because there was little backup built into the systems. Telecom players have no profit incentive to provide extra capacity to deal with emergencies. So Washington has to either provide financial incentives for companies to build spare capacity or pay for it directly.

The same just-in-time problems apply to hospitals, medical supplies, and vaccines. There are few stockpiled beds and medicines to deal with catastrophes. Access to cipro to fight anthrax and smallpox vaccines remains limited. A medical cushion is needed. "Communities have to have a surge response in hospitals," says Dr. Redlener.

» PRIORITIZE SPENDING The federal government already spends billions annually on Homeland Security, public works, and public health to defend against disasters, but it is not focused on areas of greatest threat. The democratic political culture that so defines America also acts to dilute resources across 50 states. Congress is pouring money into Wyoming to defend against terrorist attacks that are far more likely in San Francisco or Washington. It is sending millions of dollars to Alaska to build bridges to tiny islands that could have gone to bolstering the levees of New Orleans.

The political game of buying off legislators to build a consensus around bills makes little sense when preparing for disasters. Less pork and more focus of the billions already appropriated in Congress to supporting bulwarks against disaster would make the nation safer.

» REORGANIZE THE ORGANIZATIONS Establishing clear lines of authority in case of disaster before disaster strikes is equally important. New York had them. New Orleans didn't. U.S. Appeals Court Judge Richard A. Posner, author of *Catastrophe: Risk and Response*, says each locality and state must work out a compact with federal authorities beforehand. "There's urgency, uncertainty, people running around like chickens without heads—you have to have one person in command, with staff and authority," says Posner. Why did it take four days for the National Guard to enter New Orleans?

Acting on information that falls outside the expected is also important. The FBI agent who warned about terrorists in flight schools, the engineers who asked for photos when the space shuttle's wing was hit by foam, the people who wrote reports of problems with New Orleans' levees—all were signaling disaster, and all were ignored by decision makers who couldn't, or didn't want to, imagine what they foretold.

The economic cost of September 11 was $70 billion. The tab for the New Orleans flooding could top $200 billion. An avian flu pandemic could cost trillions. We are quickly learning the costs of not managing the risks of disaster. Spending to prepare for worst-case scenarios may be far cheaper.

But much depends on our political culture. In the past America's political system has chosen to react to rather than plan for catastrophe. Politicians reflected the fears and reluctance of their constituents to grapple with disaster. New Orleans and New York show that it is time for them to begin to inform those they represent of the real risks that lie ahead and the real costs of preparing for them. It may be that people are finally ready to hear that message. What must be done is already clear. Getting there quickly is the challenge ahead. ■

–With Cathy Arnst and Otis Port in New York and Joseph Weber in Chicago

NATURAL DISASTER SCENARIO

THE DAY CALIFORNIA CRACKS

Budget crises have left the state ill prepared for a big quake

IT'S POWER LUNCH TIME in Los Angeles. Media moguls are picking through their Cobb salads at Spago in Beverly Hills. Then the floor begins to move, first in undulating waves, then in increasingly violent jolts. The airy restaurant rumbles. Diners scream as the walls of the popular indoor garden room begin to shake, sending debris everywhere. Outside, along nearby Rodeo Drive, car alarms start to wail as upscale storefronts explode in a shower of glass and mannequins. A lonely poodle yaps in search of its master, who lies beneath an ornate streetlight.

Five miles to the east, downtown L.A.'s high-rises are swaying. As the 54-story Wells Fargo Tower buckles, a torrent of glass showers office workers along South Grand Avenue. More debris cascades down from the 72-story U.S. Bank Tower nearby, just as the elevated 10 Freeway buckles, sending delivery trucks over its sides and sports cars into each other. In the distance, fireballs ignite where natural-gas pipelines have surrendered to the violent shak

It sounds like a Hollywood disaster movie, all right. sooner or later, when the Big One hits, it will be all too real certain as California's sunny days, palm trees, and celeb politicians, a massive earthquake is coming. With more th 300 faults beneath Southern California, and the giant San dreas fault running through the state, California is a seis time bomb. A magnitude 7 quake has a 62% chance of hitt San Francisco in the next 30 years, according to the U.S. G logical Survey (USGS); the risk for L.A. is only slightly less. S a powerful quake would cause far more damage than the te blors that shook San Francisco in 1989 or L.A.'s Northri neighborhood in 1994. A magnitude 7 quake that struck dur a workday on a recently discovered fault under L.A. would 7,000 to 18,000 people, says the USGS. In San Francisco, 5,8 people would die if a temblor the size of the 1906 quake ag savaged the city.

NO WARNING

A SHAKER OF THAT SIZE, especially in the densely packed eas of L.A. or San Francisco, could make the horrific sights fr Katrina look almost tame. Because there would be no wa ing—no CNN satellite shots like the ones that plotted Katrin swirling path toward New Orleans—there would be no eva ation. Virtually every one of L.A.'s freeways would be destroy says Lucille M. Jones, USGS chief scientist for Southern C fornia. That could cut off supplies and needed help. Railw would be destroyed. Natural-gas lines would rupture. The gi Port of Los Angeles, which itself sits on a fault, would likely out of commission, stalling shipments of autos, electronics,

» Communities are waking up to the fact that they must fend for themselves

er cargo that it handles along with adjoining Long Beach. estimated hit to the local economy from the port closure: billion. All told, if the quake hit directly below L.A., the nage could top $250 billion, a USGS study predicted.

atastrophic damage would also occur if a giant quake were tered below the San Francisco Bay area, or farther down the st under Silicon Valley. The region's network of bridges could ble down and the port in Oakland would likely grind to a . And, just as L.A.'s entertainment industry would be laid by a big quake, Silicon Valley would be dealt a terrible blow s surviving creative minds and venture capitalists would be ed to relocate, creating nothing less than a tech diaspora.

Iow prepared is the state in the face of such potential de- ction? Since the 1989 Bay Area quake, a 6.9 temblor that left 63 people dead, California has improved building codes for its schools and hospitals and has beefed up its Office of Emergency Services response capabilities. But political wrangling, a state budget crisis, and the federal government's fixation on putting most of the Federal Emergency Management Agency's money into anti-terrorism efforts has left California short of where it had hoped to be. "We're better than we were five or ten years ago," says state Senator Elaine Alquist, chairman of the Public Safety Committee. "But we're certainly not prepared."

No doubt, California has learned from the rubble of its past disasters. The state has spent billions to upgrade most of its overpasses, and has retrofitted many of its schools. But there hasn't been enough money for everything. A 2002 inventory by the state architect's office found 2,100 of the 9,600 schools surveyed are "not guaranteed" to hold up in future earthquakes. Many hospitals are in financial distress and don't have the funds to complete needed retrofits, says the California Seismic Safety Commission. Ballot measures have since been passed to upgrade both schools and hospitals.

GRASS-ROOTS EFFORTS

STILL, PRECIOUS TIME has been lost. Plans to make the San Francisco Bay Bridge, which was partially destroyed in 1989, more earthquake-resistant have been delayed for eight years over design and funding controversies. Final plans were agreed to only this past July. The federal government's policies haven't helped much either. In the most recent Bush Administration budget, FEMA intends to spend three of every four dollars of its $3.4 billion in grant funds on anti-terrorism efforts, leaving little for earthquake preparedness. Fearing a New Orleans-like break in California levees, Senator Dianne Feinstein on Sept. 6 urged Congress to appropriate the $90 million it authorized to shore up levees along the Sacramento-San Joaquin Delta. "A major breach in these levees could imperil hundreds of thousands of people and endanger most of the state's water supply," Feinstein wrote.

The good news is, with the feds scaling back, communities are finding ways to fend for themselves. The city of Palo Alto is recruiting more volunteers for its emergency response team. And the state's Office of Emergency Services has increased from 8 to 13 the number of 60-person emergency teams, made up largely of local police, fire, and medical personnel. California companies are also taking the threat seriously. Intel Corp. has built its $2 billion chip-fabrication plant in Santa Clara on giant rollers to withstand a large quake.

Of course, all Californians know that no one is ever completely safe in a big quake. But they're waking up to the fact that they need to do more. Sacramento is spending an estimated $10

f A Major Quake Hit Los Angeles

lere's how the damage could spread:

UILDINGS	TRANSPORTATION	ENERGY
A quake could cause some $69 billion damage to structures. And if it hit uring work hours, thousands could be apped inside damaged skyscrapers and llapsed parking garages.	» All of L.A.'s major highways would crumble, except perhaps Route 101 north. Rail traffic would be disrupted and cargo would back up at the ports, causing an estimated hit to the local economy of $36 billion.	» Major refineries could be damaged. Crude shipments from Alaska would be stopped. Natural gas pipelines built along fault lines could be severed, resulting in potentially explosive gas leaks.

billion in hospital retrofits and voters have approved $25 billion in new bonds, partially to help make schools more quake-resistant. Still, the question remains: Will that sum, or any amount, be enough to truly cushion against the Big One when it finally hits? ■

–By Ronald Grover and Christopher Palmeri in Los Angeles, with Louise Lee in San Mateo, Eamon Javers in Washington and bureau reports

MEDICAL DISASTER SCENARIO

A HOT ZONE IN THE HEARTLAND

Little could be done to contain a deadly avian flu outbreak

THERE'S A FAST-SPREADING avian flu virus killing millions of chickens in Asia, and it has mutated into one that is transmitted among humans. People start falling ill in Southeast Asia, but it takes weeks to recognize what is happening. An American businessman from Chicago completes a deal in Hanoi and flies back to O'Hare, the busiest airport in the world. O'Hare has one of only 11 stations in the U.S. capable of quarantining sick international travelers, but everyone on this flight seems fine. In any case, there have been no reports of a flu outbreak in Vietnam.

The businessman heads first to the office and then home. Meanwhile, one of his seatmates on the plane has flown on to Denver, another to New York. In a few days the businessman develops a high fever that drugs can't quell and is admitted to a hospital. Within a week, his lungs fail and he dies. Doctors assume a severe case of flu. Only after the pathologist's report comes back a week later do they learn he was infected with H5N1, the deadly virus that causes avian flu. It's easily spread through the air, and currently there's no vaccine.

One week later, Chicago has thousands of avian flu cases and the city is drawing down the nation's supplies of Tamiflu, a drug made in Switzerland by Hoffmann-La Roche Inc. that's the only antidote. The U.S. has enough Tamiflu for only a few million patients—none of it stored in Chicago. By now there are outbreaks in New York, in Denver, and dozens of other regions across the nation. Fear of contagion has slowed the nation's transportation network to a crawl, and health-care workers in particular are rapidly succumbing.

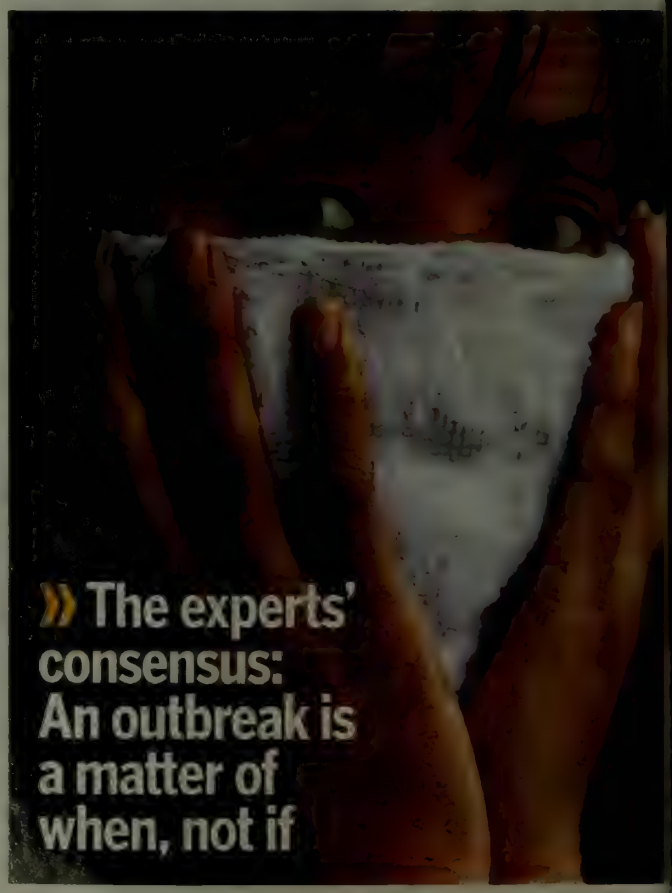
As many as 50% of those stricken are dying, and half are ages 18 to 40. The U.S. can't turn to other nations for help—the disease is speeding around the globe, and the media is comparing it to the 1918-19 Spanish flu pandemic, which killed up to 40 million world

The comparison would be on target. The Centers for ease Control & Prevention estimates that 25% of the U.S. ulation, 67 million victims, might fall ill in an avian flu demic. Even if a vaccine is developed, it would take six m to produce one tailored to the viral strain causing the demic, and the world's extremely limited vaccine produ capacity means only 14% of the global population could oculated within a year of the outbreak. "The differenc tween this and a hurricane is that all 50 states will be aff at the same time," says Michael T. Osterholm, an infec disease expert at the University of Minnesota. "And this will last a year or more. It will utterly change the world.

The change would spread far beyond the number of de Most experts predict that an avian flu outbreak in the would overwhelm hospitals, decimate workforces, and t transportation and supply chains into chaos. Because wide use of just-in-time inventory control and dependen medical supplies made overseas, drug and food shor would arise almost instantly. The nonprofit Trust for A ca's Health estimates that the economic impact of a mode size flu pandemic on the U.S. could reach $166.5 billion death and lost productivity alone. That figure excludes " disruptions to commerce and society."

DEADLY DELAY

UNLIKE SOME OTHER TYPES of disasters, prevention is to impossible. A recent computer model prepared by E University suggests that rapid treatment and containme patients at the site of the first outbreak, almost certain Southeast Asia, would delay its spread long enough to pro more vaccine—but only if those measures were instituted in 21 days. Since Thailand is the only country in the region has a pandemic plan, that scenario is unlikely.



» The experts' consensus: An outbreak is a matter of when, not if

37 ties but only one will do.

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Once a flu virus starts spreading, quarantines do little good, says Marc Lipsitch, a Harvard University epidemiology professor, because the flu infects dozens of people within minutes by a cough or sneeze. People who acquired SARS, a far less contagious disease that hit Asia and Canada two years ago, did not become infectious themselves for at least a week. Carriers of a flu virus become infectious within two to four days, often before they develop symptoms.

If Avian Flu Strikes Chicago

A whole region would soon be on life support:

HEALTH CARE Based on conservative assumptions, more than 2 million people in greater Chicago might get sick, and half of them could die.

TRANSPORTATION The city would shut down O'Hare and Midway airports, which serve 95 million passengers a year and process 29 million tons of cargo, disrupting nationwide air travel and shipping.

MANUFACTURING With just-in-time inventory control common at three dozen major companies headquartered in the area, stockpiles of food and gear would soon be depleted.

Chicago officials have been meeting with federal and state authorities to develop better plans for handling such disasters. "We're not sitting back on our heels," says Dr. Pamela S. Diaz, infectious disease director at Chicago's Dept. of Public Health. Yet the many drumbeats warning of an imminent avian flu outbreak are growing louder. On Sept. 7, a World Health Organization official cautioned that we may be at the last stage before a pandemic virus emerges. "Whether the avian influenza pandemic will occur, that is not the question any more," said Dr. Jai P. Narain, the director of WHO's communicable diseases department. The consensus among infectious disease experts stems from the fact that a flu pandemic has emerged every 25 to 30 years for centuries.

Not all virus strains are as virulent as the Spanish flu, which killed 500,000 Americans. A flu outbreak in 1957-58 killed 70,000 in the U.S., and the relatively mild Hong Kong flu outbreak of 1968-69 caused 37,000 deaths. It's possible that H5N1 could mutate into a benign virus that causes little harm to humans. But most experts believe that this strain will lean toward the deadlier end of the scale.

So far, the virus has killed approximately half of the 109 humans it has infected in Asia—presumably through contact with infected birds. This summer, H5N1 was found in pigs, which often act as incubators for a human infection. "This organism is following the historical playbook step by step," says Dr. Georges C. Benjamin, head of the American Public Health Assn.

Right now, the U.S. has no national pandemic preparedness plan, either for treating large numbers of patients or for dealing with the resulting economic and social disruptions. "We can't handle a pandemic flu," asserts Dr. Redlener of the National Center for Disaster Preparedness. "We don't have enough capacity in our health care system. We can't handle hundreds of people a day dying." His dire assessment is based on the fact that U.S. public health authorities have been woefully underfunded for decades.

Washington is starting to get the message. Earlier this year, WHO called on member nations to pony up at least $100 million to develop an international response. Congress qu pledged $25 million and funded the purchase of 3 m courses of Tamiflu, adding to the 2.3 million already on h Senator Barack Obama (D-Ill.) hopes to establish a nat pandemic influenza preparedness committee.

On the treatment front, the National Institutes of Hea racing to test experimental vaccines. And world governn have been meeting regularly over the past year to figur how to increase global vaccine capacity. WHO believes th world has a chance of preventing a catastrophe because had plenty of notice about the pandemic. Now, it's up t nations to act on that warning. ■

–By Catherine Arnst, with Arlene Weintraub in New Joseph Weber and Michael Arndt in Chi and Stan Crock in Washi

TERRORISM SCENARIO

NEW YORK TAKES ANOTHER HIT

It has been readying itself for dirty bomb since 9/11, but...

AT 8:30 A.M. ON A Tuesday morning, as c muters converge on Manhattan, an al Q operative explodes a dirty bomb outside New York Stock Exchange. The device, w not especially powerful, contains a radioa payload—in this case, cesium extracted f radiological equipment that was stolen fr New Jersey hospital by a sleeper working there as a lab tech

The initial blast kills only a few dozen people, but radiati quickly dispersed by the prevailing winds. Minutes after the plosion, New York City Police officers arrive—still unaware o real nature of the blast. But when a radiation detector in on ficer's car goes wild, it becomes clear that a dirty bomb has d nated in the financial center of America's biggest city.

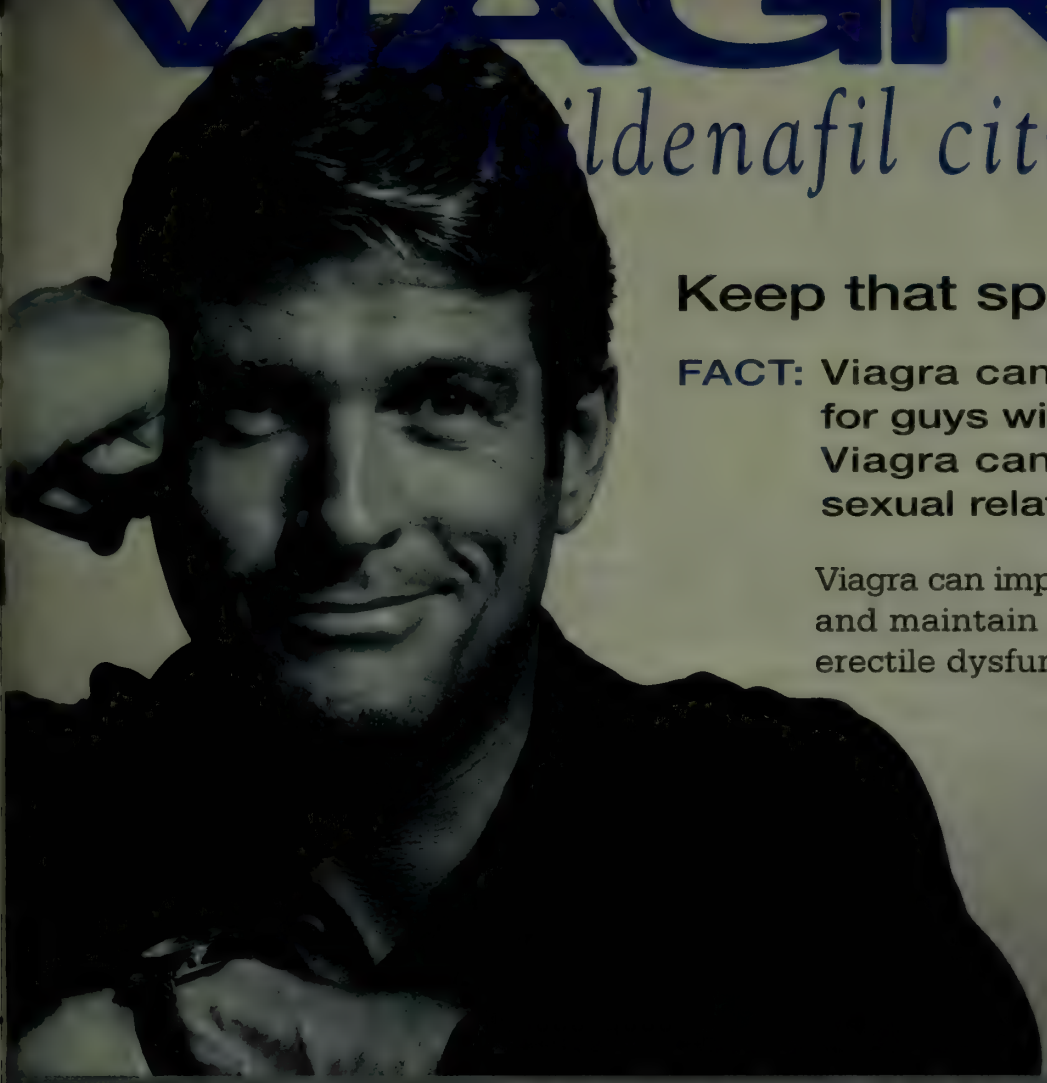
Word of the explosion reverberates throughout New Y Many residents panic—despite assurances from the mayor police chief that contamination levels would exceed governn limits only in about 40 city blocks. And by 3 p.m., half of M hattan has tried to leave, clogging trains, highways, and brid

Six months later, the financial district remains largely off- its, and the local economy is limping along amid a craterin business confidence, the collapse of the tourism industry, a property market in free fall. Economists put the eventual nomic losses at an astronomical $1 trillion.

If that all-too-plausible attack happened tomorrow, w New York be ready? The good news is that since Septembe

VIAGRA®

(sildenafil citrate) tablets



Keep that spark alive.

FACT: Viagra can improve erections for guys with ED. Studies show Viagra can also improve their sexual relationship satisfaction.

Viagra can improve the ability to achieve and maintain an erection for guys with erectile dysfunction. **Ask your doctor if VIAGRA is right for you.**

To learn more, visit viagra.com or call 1-888-4VIAGRA

VIAGRA is prescribed to treat erectile dysfunction. We know that no medicine is for everyone. If you use nitrate drugs, often used for chest pain (known as angina), don't take VIAGRA. Taking these drugs together could cause your blood pressure to drop to an unsafe level.

The most common side effects of VIAGRA are headache, facial flushing, and upset stomach. Less common are bluish or blurred vision, or being sensitive to light. These may occur for a brief time. Remember to protect yourself and your partner from sexually transmitted diseases.

Talk with your doctor first. Make sure you are healthy enough to have sex. If you have chest pain, nausea, or other discomforts during sex, seek medical help right away. Although erections lasting for more than four hours may occur rarely with all ED treatments in this drug class, it is important to seek immediate medical attention. Erections lasting longer than six hours can result in long-term loss of potency.

VIAGRA is covered under most Managed Care Plans.*

Important Information: Viagra is one of several ED treatments that you and your doctor can consider.

Please see our patient summary of information for VIAGRA (25 mg, 50 mg, 100 mg) tablets on the following page.
*Percent of members by formulary status for HMOs, PPOs and POS for Viagra, Levitra, and Cialis. *Formulary Compass*™ MediMedia USA, Inc. February 2005.

Pfizer U.S. Pharmaceuticals

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Pfizer helpful answers™

PATIENT SUMMARY OF INFORMATION ABOUT

VIAGRA®

(sildenafil citrate) tablets

This summary contains important information about VIAGRA®. It is not meant to take the place of your doctor's instructions. Read this information carefully before you start taking VIAGRA. Ask your doctor or pharmacist if you do not understand any of this information or if you want to know more about VIAGRA.

This medicine can help many men when it is used as prescribed by their doctors. However, VIAGRA is not for everyone. It is intended for use only by men who have a condition called erectile dysfunction. **VIAGRA must never be used by men who are taking medicines that contain nitrates of any kind, at any time. This includes nitroglycerin. If you take VIAGRA with any nitrate medicine your blood pressure could suddenly drop to an unsafe or life threatening level.**

• What Is VIAGRA?
VIAGRA is a pill used to treat erectile dysfunction (impotence) in men. It can help many men who have erectile dysfunction get and keep an erection when they become sexually excited (stimulated).

You will not get an erection just by taking this medicine. VIAGRA helps a man with erectile dysfunction get an erection only when he is sexually excited.

• How Sex Affects the Body
When a man is sexually excited, the penis rapidly fills with more blood than usual. The penis then expands and hardens. This is called an erection. After the man is done having sex, this extra blood flows out of the penis back into the body. The erection goes away. If an erection lasts for a long time (more than 6 hours), it can permanently damage your penis. You should call a doctor immediately if you ever have a prolonged erection that lasts more than 4 hours.

Some conditions and medicines interfere with this natural erection process. The penis cannot fill with enough blood. The man cannot have an erection. This is called erectile dysfunction if it becomes a frequent problem.

During sex, your heart works harder. Therefore sexual activity may not be advisable for people who have heart problems. Before you start any treatment for erectile dysfunction, ask your doctor if your heart is healthy enough to handle the extra strain of having sex. If you have chest pains, dizziness or nausea during sex, stop having sex and immediately tell your doctor you have had this problem.

• How VIAGRA Works
VIAGRA enables many men with erectile dysfunction to respond to sexual stimulation. When a man is sexually excited, VIAGRA helps the penis fill with enough blood to cause an erection. After sex is over, the erection goes away.

• VIAGRA Is Not for Everyone
As noted above (*How Sex Affects the Body*), ask your doctor if your heart is healthy enough for sexual activity.

If you take any medicines that contain nitrates – either regularly or as needed – you should never take VIAGRA. If you take VIAGRA with any nitrate medicine or recreational drug containing nitrates, your blood pressure could suddenly drop to an unsafe level. You could get dizzy, faint, or even have a heart attack or stroke. Nitrates are found in many prescription medicines that are used to treat angina (chest pain due to heart disease) such as:

- nitroglycerin (sprays, ointments, skin patches or pastes, and tablets that are swallowed or dissolved in the mouth)
- isosorbide mononitrate and isosorbide dinitrate (tablets that are swallowed, chewed, or dissolved in the mouth)

Nitrates are also found in recreational drugs such as amyl nitrate or nitrite ("poppers"). If you are not sure if any of your medicines contain nitrates, or if you do not understand what nitrates are, ask your doctor or pharmacist.

VIAGRA is only for patients with erectile dysfunction. VIAGRA is not for newborns, children, or women. Do not let anyone else take your VIAGRA. VIAGRA must be used only under a doctor's supervision.

• What VIAGRA Does Not Do
- VIAGRA does not cure erectile dysfunction. It is a treatment for erectile dysfunction.
- VIAGRA does not protect you or your partner from getting sexually transmitted diseases, including HIV — the virus that causes AIDS.
- VIAGRA is not a hormone or an aphrodisiac.

• What To Tell Your Doctor Before You Begin VIAGRA
Only your doctor can decide if VIAGRA is right for you. VIAGRA can cause mild, temporary lowering of your blood pressure. You will need to have a thorough medical exam to diagnose your erectile dysfunction and to find out if you can safely take VIAGRA alone or with your other medicines. Your doctor should determine if your heart is healthy enough to handle the extra strain of having sex.

Be sure to tell your doctor if you:

- have ever had any heart problems (e.g., angina [illegible] pain, heart failure, irregular heart beats, heart attack or [illegible] of the aortic valve)
- have ever had a stroke
- have low or high blood pressure
- have ever had severe vision loss
- have a rare inherited eye disease called ret[illegible]
- have ever had any kidney problems
- have ever had any liver problems
- have ever had any blood problems, including [illegible] anemia or leukemia
- are allergic to sildenafil or any of the other ingre[illegible] of VIAGRA tablets
- have a deformed penis, Peyronie's disease, or ever had an erection that lasted more than 4 hours
- have stomach ulcers or any types of bleeding problems
- are taking any other medicines

• VIAGRA and Other Medicines
Some medicines can change the way VIAGRA works. Tell your doctor about **any medicines** you are taking. Do not start or stop taking any medicines before checking with your doctor or pharmacist. This includes prescription and nonprescription medicines or remedies:

- Remember, VIAGRA should never be used with medicines that contain nitrates (see *VIAGRA Is Not for Everyone*).
- If you are taking alpha-blocker therapy for the treatment of high blood pressure or prostate problems, you should not take a dose of greater than 25 mg of VIAGRA at the same time (within 4 hours) as you take your dose of alpha-blocker.
- If you are taking a protease inhibitor, your dose may be adjusted (please see *Finding the Right Dose for You*).
- VIAGRA should not be used with any other medical treatments that cause erections. These treatments include pills, medicines that are injected or inserted into the penis, implants or vacuum pumps.

• Finding the Right Dose for You
VIAGRA comes in different doses (25 mg, 50 mg and 100 mg). If you do not get the results you expect, talk with your doctor. You and your doctor can determine the dose that works best for you.

- Do not take more VIAGRA than your doctor prescribes.
- If you think you need a larger dose of VIAGRA, check with your doctor.
- VIAGRA should not be taken more than once a day.

If you are older than age 65, or have serious liver or kidney problems, your doctor may start you at the lowest dose (25 mg) of VIAGRA. If you are taking protease inhibitors, such as for the treatment of HIV, your doctor may recommend a 25 mg dose and may limit you to a maximum single dose of 25 mg of VIAGRA in a 48 hour period. If you are taking alpha-blocker therapy, you should not take a dose of greater than 25 mg of VIAGRA at the same time (within 4 hours) as your dose of alpha-blocker.

• How To Take VIAGRA
Take VIAGRA about one hour before you plan to have sex. Beginning in about 30 minutes and for up to 4 hours, VIAGRA can help you get an erection if you are sexually excited. If you take VIAGRA after a high-fat meal (such as a cheeseburger and french fries), the medicine may take a little longer to start working. VIAGRA can help you get an erection when you are sexually excited. You will not get an erection just by taking the pill.

• Possible Side Effects
Like all medicines, VIAGRA can cause some side effects. These effects are usually mild to moderate and usually don't last longer than a few hours. Some of these side effects are more likely to occur with higher doses. The most common side effects of VIAGRA are headache, flushing of the face, and upset stomach. Less common side effects that may occur are temporary changes in color vision (such as trouble telling the difference between blue and green objects or having a blue color tinge to them), eyes being more sensitive to light, or blurred vision.

In rare instances, men taking PDE5 inhibitors (oral erectile dysfunction medicines, including VIAGRA) reported a sudden decrease or loss of vision in one or both eyes. It is not possible to determine whether these events are related directly to these medicines, to other factors such as high blood pressure or diabetes, or to a combination of these. If you experience sudden decrease or loss of vision, stop taking PDE5 inhibitors, including VIAGRA, and call a doctor right away.

In rare instances, men have reported an erection that lasts many hours. You should call a doctor immediately if you ever have an erection that lasts more than 4 hours. If not treated right away, permanent damage to your penis could occur (see *How Sex Affects the Body*).

Heart attack, stroke, irregular heart beats, and death have been reported rarely in men taking VIAGRA. Most, but not all, of these men had heart problems before taking this medicine. It is not possible to determine whether these events were directly related to VIAGRA.

VIAGRA may cause other side effects besides those listed on this sheet. If you want more information or develop any side effects or symptoms you are concerned about, call your doctor.

• Accidental Overdose
In case of accidental overdose, call your doctor right away.

• Storing VIAGRA
Keep VIAGRA out of the reach of children. Keep VIAGRA in its original container. Store at 25°C (77°F); excursions permitted to 15-30°C (59-86°F) [see USP Controlled Room Temperature].

• For More Information on VIAGRA
VIAGRA is a prescription medicine used to treat erectile dysfunction. Only your doctor can decide if it is right for you. This sheet is only a summary. If you have any questions or want more information about VIAGRA, talk with your doctor or pharmacist, visit www.viagra.com, or call 1-888-4VIAGRA.

U.S. Pharmaceuticals

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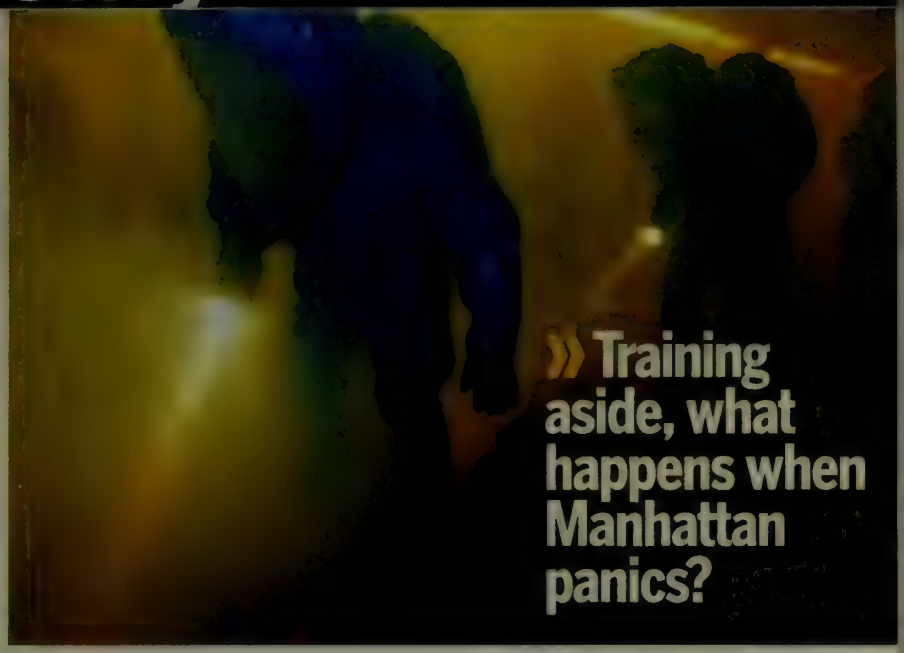


» Training aside, what happens when Manhattan panics?

e city has been preparing and drilling for a range of ter- r threats, including a dirty bomb. In April, New York arified the roles of city agencies during a disaster. Under e plan, police would be the commanders at the scene, t fire personnel would be involved in tackling any bio- gical, radiological, or chemical attack, and the city's de- rtment of health would establish the size of the con- minated zone. "New York City knows how to deal with [dirty bomb] better than any other city in the country," ys former Police Commissioner Howard Safir.

Maybe so, but there's still a lot of work to be done— nging from developing a coordinated response with ighboring states to educating the public on what to do the event of such an attack. Says Stephen E. Flynn, a meland security expert and author of *America the Vul- rable*: "New York isn't prepared" for a radiological at- ck.

One of the first challenges for the police and fire depart- ents would be decontaminating people. That would re- ire setting up decon centers and persuading people to rip naked and submit to a brutal shower from a fire hose. harles Ferguson, an adviser to the city, says New York claims it n handle the decontamination of thousands of people an hour t actually has a "very limited capacity."

What's more, regional hospitals and emergency services have ceived a pittance from the Feds to help them prepare for a dirty mb or other attack, say experts. Scot Phelps, who oversees the asters program in disaster management at Metropolitan Col- ge of New York City, says most hospitals receive less than 75,000 per year, when they need three times as much. He reck- s EMS has received less than 4% of terrorist funding. With ost ambulance staffers receiving less than four hours of train- g in dealing with a radiological attack, he believes fewer than 5 New York City ambulances would be sufficiently equipped or ained to respond effectively to a dirty bomb.

And while New York is coordinating with regional govern- ent, it needs to do a better job, especially with New Jersey, here many people would flee during an attack. Rick McDonnell, assistant supervisor with the New Jersey State Exercise Sup- rt Team, which coordinates emergency management exercis- , says: "You are talking about sending thousands of New York- ers into the most densely populated state in the country." McDonnell says plans for such an event are still being formulated and expects a major exercise to be conducted in the coming months, once the details—ranging from traffic control to emergency shelters to communications—are worked out.

Even if New York had unlimited resources to throw at the problem, victims and medical personnel still might not respond appropriately. One recent survey found that just 57% of health-care workers in the region would report for work during a radiological event. Another found only three-fifths of the population would remain indoors if told to do so—potentially exposing them to radiation and putting more pressure on hospitals.

It all sounds pretty dire. Still, there is more New York can do to get ahead of the threat. If there's one thing that all experts agree on, it's that the city should fund a public education campaign, giving residents a crash course in the risks of a dirty bomb attack and what they should do to avoid contamination. "This depends on having a real adult conversation with the public, and that hasn't been done," says Flynn. "This could make the difference between tens of lives or tens of thousands." In the wake of Katrina, that seems eminently sensible.

If a Dirty Bomb Hits New York

Here's how the damage could spread:

TOURISM Even if the radiation were confined to a relatively small part of Lower Manhattan, many vacationers and business travelers would give the city a wide berth—prompting a dive in its key hotel, restaurant, and entertainment industries.

PROPERTY MARKET With thousands of residents fleeing and some companies hesitant to return to a potential hot zone, many apartments and offices would sit empty and real estate prices would plummet. Thousands of Realtors and mortgage brokers would lose their jobs.

FINANCIAL SERVICES While the NYSE and many Wall Street firms have set up backup facilities in the 'burbs, the stock market could be hit hard if business confidence sank.

SO WHAT ARE WE to make of these three apocalyptic scenarios? It would be easy to throw up our hands in despair. The magnitude of the catastrophes is so huge and our ability to take meaningful steps to mitigate the dangers seems, at first glance, minuscule. But that would be a great mistake. If the nightmare of Katrina has taught us anything it is that, to some extent, at least, our fate is in our own hands. We will never, of course, live in a risk-free society. But the tragedy of Katrina now affords us a rare opportunity to rethink the nation's approach to preparing for both natural disasters and the threat of terrorism.

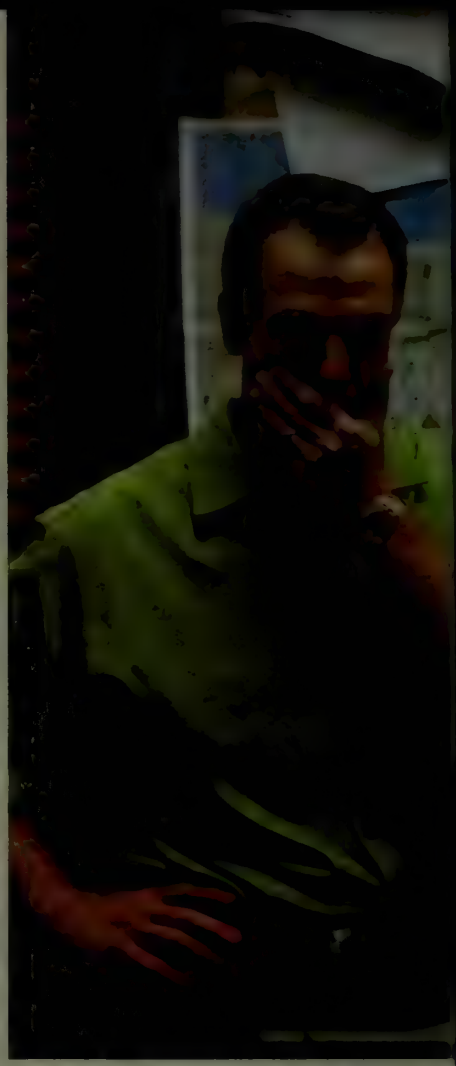
Money isn't the issue. The resources can be found to improve our communications, build more hospitals and produce greater stockpiles of critical medicines and vaccines. And indeed it will be less costly to prepare than to suffer the human and financial costs of unpreparedness. The biggest challenge will be mustering the political will to set priorities and establish clear chains of command. If leaders in Washington and state governments can do that, there's much we can accomplish and reason for hope. ■

–By Spencer E. Ante in New York and Amy Barrett in Philadelphia, with Paul Magnusson in Washington

DISPATCHES

THEY DON'T TEACH THIS IN B-SCHOOL

WHEN THE NATURAL RHYTHMS of our lives are brutally disrupted, we respond with fear, anger, calm, sometimes violence, and often with courage. Katrina was that kind of upheaval. It obliterated towns, submerged a great city, exposed a nation's frailties and prejudices, and uprooted thousands. It also brought forth untold instances of duty and determination. Here are the stories of two men and their colleagues, Gulf Coast residents who, when their world was torn apart one Monday, deftly managed their way through the storm.



'VERTICAL EVACUATION' AT THE HILTON

FRED SAWYERS, 44, THOUGHT HE WAS in for just another routine week as manager of the Hilton New Orleans Riverside. When news came that a hurricane might pass nearby, he figured the giant 1,616-room inn would be a safe haven in a short storm for staffers and their families, as well as tourists and locals who wanted to find high ground. He says old Hilton hands even have a term for accommodating storm refugees in its 29-story tower: "vertical evacuation." Instead, the Stanford University graduate who once taught English in Japan and worked in hotels on the West Coast before moving to New Orleans two years ago, survived the most harrowing week of his life.

FRIDAY, AUG. 26

A COLLEAGUE, David Blitch, hands Sawyers a weather report, saying "Katrina is aiming right for us." With the general manager on vacation, Sawyers tells the staff to offer all comers half-price rates; the $95-a-night fee goes mostly uncollected.

SATURDAY, AUG. 27

VERY QUICKLY, HALF the hotel's rooms are booked up, and many are packed with extra family members. An additional 200 reservations come in. Meanwhile, about 450 employees and their families have taken cots into the health club. By nightfall, Sawyers counts some 4,500 occupants, plus various pets. He cuts off more reservations: "I don't want to overtax our resources."

SUNDAY, AUG. 28

AFTER SPENDING the night at home in a nearby neighborhood, Sawyers and his wife, Jayme, gather up their valuables a three cats and prepare to head back to t hotel. But he's uneasy about his wife sta ing. "Baby, I don't want you to come," tells her. "I don't have a good feeli about this. I think you should evacuate She leaves for Little Rock, Ark.

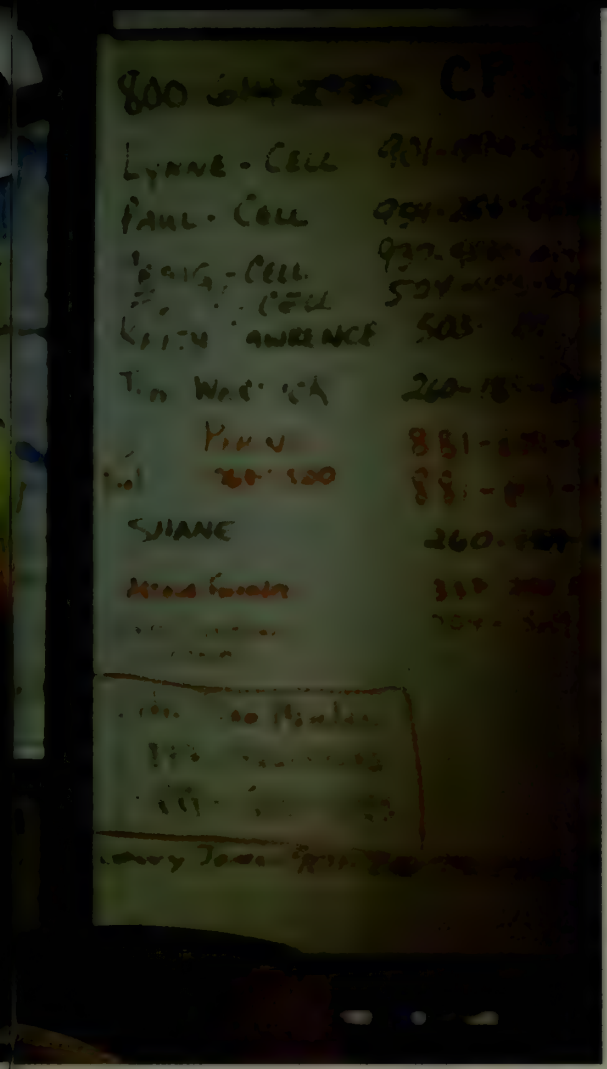
HIT The New Orleans hotel was heavily damaged

MONDAY, AUG. 29

BY 5 A.M., THE RAIN is thundering dow the wind is howling, and the sky is grov ing dark. On an open-air third level of t hotel, a cabana rips loose from its moo ings, shattering a glass door and exposi an area that's being used to serve mea "Now that's compromised," Sawyers sa Water covers the floor, and the wind roa

As the storm intensifies, the aluminu roof of the health club starts peeling bac The water pours in. Employees wi flashlights guide the 450 people the through darkened hallways and stairwe to the first-floor grand ballroom.

Returning to the third floor, where pe ple are grabbing breakfast, Sawye shouts at guests to sta clear of the windo where some are wat ing the storm rage. On a few rooms have the



REFUGE At one point, Hilton's Sawyers sheltered more than 4,500

indows blown out, but he worries that 'll have to treat wounded guests, cut by ing glass. Members of his staff close the ackout curtains and hunker down for x hours of a raging storm. In the end, no e is injured.

Leaks begin sprouting from ceilings d exposed areas. Tiles fall 70 feet onto e marble floor near the front desk. "Nody was hurt, but it was scary," he says. en water threatens the computer sysms. Larry Imhoff, a 72-year-old veteran nployee who runs property operations, sures Sawyers that the building won't il. Sawyers passes the message on in a rsonal call with the chain's co-chairan, Barron Hilton.

Sawyers and his staff continue feeding eir 4,500 refugees, bringing food dictly to those who aren't able to walk own the stairs.

UESDAY, AUG. 30.

HE RAIN HAS STOPPED, and roads earby are passable. Sawyers has been ncouraging guests with cars to leave. housands do just that. Executives want know when he can book guests again.

Soon, however, there are reports that rts of the city to the east are flooding. Sawyers worries that there won't be enough diesel fuel to keep the generators going. He limits water for showers and flushing toilets to the early morning and evenings.

Some of the elderly and ill begin to fret about their lack of medicine. A group of emergency rescue workers, in town for a convention, try to calm them even though they can offer nothing for diabetes or heart conditions. "They were just sort of talking them down," Sawyers says.

WEDNESDAY, AUG. 31

BY LATE Wednesday, the hotel population has shrunk to about 800. Individual stories of heroism abound. One employee, marketing director Eric Janecke, has carried elderly women down 16 flights of stairs because their rooms, without air conditioning, are stifling.

The fetid heat grows unbearable, with a heat index of 110 or so. Sawyers and others break out in rashes. They decide it's time for everyone to leave. Hilton executives arrange for 19 charter buses, paying wary drivers extra to make the trip from Texas.

Sawyers and his colleagues check each room and assemble everyone inside the hotel. They wait for hours. There's talk the buses can't get in because of lack of security.

Someone has a small portable TV, and they've heard news of looting. People begin to grow fearful of being attacked. A few police officers stop by once in a while, mostly out of loyalty to Joe Lopinto, a former captain who now heads the hotel's security detail. They chase at least one looter off, but an access door is shattered.

Finally, Sawyers gets word that the buses are en route and will take people to Baton Rouge, about 80 miles away.

THURSDAY, SEPT. 1

AT ABOUT 3 A.M., the empty buses slip into the city in groups. The first seven drive behind the nearby convention center to avoid the angry crowd there and pull up behind a wall, headlights off. The others, though, mistakenly pass right in front of the convention center. Fearing that the buses could be overrun, Sawyers and his staff barricade a hotel corridor with benches. With four police officers guarding them, the 800 guests and staff are quietly loaded on in about 35 minutes. "We were all just praying that nobody would take sniper shots. It seemed like forever," he says.

Around 4 a.m., after securing the hotel as much as possible, Sawyers and his managers head out in their own cars, headlights off, toward Baton Rouge.

TODAY THE HOTEL has power again but remains unoccupied. Armed security guards patrol the property. Sawyers is helping Hilton staffers willing to move find jobs at other hotels in the chain. And he's trying to make sure all 2,000 employees in the region get their pay. Even Hilton Hotels Co-Chairman Stephen F. Bollenbach won't hazard a guess as to when the Riverside might reopen. Will Sawyers be around to help run it? He'll have to think about that. ■

–By Joseph Weber in Chicago, with Christopher Palmeri in Los Angeles

WHEN A LOCAL WAL-MART IS A LIFELINE

WHEN A HUNGRY MAN THREATENED to get his gun if Wal-Mart didn't open its doors on Aug. 30, the day after Hurricane Katrina smashed through town, store manager Ray Mathews knew he had trouble. The storm had shattered skylights and flooded his Wal-Mart Supercenter in Columbia, Miss., 100 miles north of New Orleans. Food was spoiling, the power was out, and many of his 400 employees were stranded. But against all odds, Mathews, an Air Force veteran who served two tours of duty in Vietnam, and his staff were able to get the store reopened in just four days. The story of how they pulled off that feat is a microcosm of heroic efforts all across the Gulf States as citizens toil to rebuild.

TUESDAY, AUG. 30-WEDNESDAY, AUG. 31

FOR MATHEWS, 57, the immediate challenge in the first two days after the storm is

to keep the ire of desperate customers from turning into violence as he works to reopen the store. Thanks to a small generator, the gas pumps are working. But martial law is declared in the town, in part because of knife and fistfights in the supercenter's parking lot as frustrated customers line up for what seems like a mile to fill their tanks at Wal-Mart, the lone fuel outpost for 30 miles.

BATTLE-TESTED Air Force vet Mathews did two tours in Vietnam

Columbia is devastated. The recently refurbished downtown is in tatters. Prisoners from the local jail, dressed in black-and-white striped uniforms, haul away debris, under guard. On side streets hundreds of shredded trees have clipped power lines and damaged roofs. "It looked like a bomb went off," Mathews says. Including Columbia's Wal-Mart, 126 of the big-box stores in Mississippi, Louisiana, and Alabama were knocked off line in the wake of the hurricane.

Mathews' military training starts to pay off right away. He places an order for trailers of water, canned meats, juices—and a giant Caterpillar generator. Repairmen put temporary plastic shields on the store's broken skylights. Store employees stumble back to work. "We had no idea about anything until we came in," says Willie Nell Binkley, the housewares-department manager, who tracks down her missing daughter using a store phone.

For the 6,500 people of Columbia, a quiet place where annual incomes average around $20,000, Wal-Mart will become a lifeline.

THURSDAY SEPT. 1-FRIDAY SEPT. 2

EMPLOYEES STAY BUSY clearing out spoiled meat and vegetables from the back room, mopping floors, and checking inventory. In the parking lot, the staff room, and the grocery aisles, Mathews barks near-constant orders into his walkie-talkie and listens for relief updates on a police radio given to him by the city. "It's been a bit of chaos," says Mathews, a 19-year veteran of Wal-Mart who is known to workers and customers alike as "Mr. Ray."

When the Caterpillar generator—a machine the size of a house that sucks up 100 gallons of fuel an hour—arrives, electricians hotwire the store to hook it up. Water arrives, too, and in the middle of the night staffers pile cases of it—priced at $1.47 for two gallons—in the aisles. Mathews puts up a sign in the window: "We will open 9:00 a.m. to 5:00 p.m. Only 20 customers in at a time." Eager shoppers line up 100 deep at 7 a.m. on Sept. 2. One, Tammy Alexander, trekked 40 miles north from Angie, La., where there's no water, ice, electricity, or gas. A Wal-Mart in Bogalusa, La., nearer to her home, is still closed. "We ain't got nuthin'," she says.

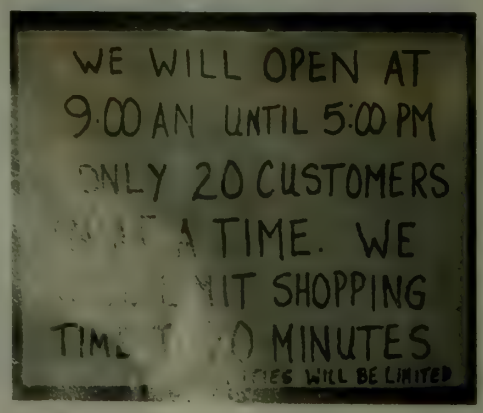
DAY FOUR Mathews managed to be fair and keep order

"It looked like a bomb went off...it's been a bit a chaos."

—Ray Mathews, manager of the Columbia (Miss.) Wal-Mart, where fights broke out in the parking lot

SATURDAY SEPT. 3-WEDNESDAY SEPT. 7

TALES OF LOSS continue to unfold. On Sept. 3 gasoline sales are still restricted to employees, soldiers, and hospital workers. A lone taxicab stands out fr the crowd, driven by Harry Smith a filled with his two daughters, th boyfriends, and a puppy. They fled J ferson Parish, west of New Orleans, day before the storm, and were head to a relative's home in Montgome Ala., about 300 miles away. They about out of gas. "You don't know h hard it is," says Smith, crying. Wit pained look, Mathews waves th through to the pumps.



In other ways, a semblance of calm turns to the store. Over the weeke shipments flow in more regularly. Tuesday night, the store receives gene tors, coolers, and lantern lights—nec sities in an area that is still largely wi out power. Tap water is back in sp though. "They could get a sponge ba then come to work," says Mathews employees who start to trickle in. He enough staff now to man cash regist in the sporting goods and electron departments, critical posts beca those products are desirable to thiev And on Sept. 5 the mayor of Colum lets Mathews start selling beer agai welcome news to overworked repairm and tree-cutters.

Ray Mathews is now keeping store open from 8.a.m. to 9 p.m. hopes to have his 188,000-square-f Wal-Mart back to its all-night operati by Sept. 10. But frozen food, meat, a deli products are still in short sup There's much more to worry about: employees of the Columbia store s haven't been heard from. There are fe that some of them may not have surviv the storm. ■

—By Brian Grow in Columbia, M

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ENERGY

IT'S EASIER BEING GREEN

Conservation is making a comeback—driven by gut as much as high gas prices

FOR THE PAST YEAR, MAINstream economists have been increasingly surprised as Americans shrugged off rising energy prices. Econ 101 says that demand falls when prices rise, but consumers seemed nonchalant as gas went to $2 a gallon and then, in August, $2.50.

Hurricane Katrina may finally have broken through the wall of indifference—and not just by pushing gasoline prices higher still. Katrina hit people in the gut, which is where they really make decisions. It provoked shock when prices soared past $3 a gallon, as well as fear that gas could simply run out, as happened at some stations in the hurricane's aftermath.

Even though prices are receding and gas lines have disappeared, research by behavioral economists shows that emotionally searing events continue to affect people's behavior long after the facts on the ground change. That's what happened in the 1980s when Americans kept buying small, fuel-efficient vehicles long after gas prices had fallen back to earth. It wasn't until the early 1990s that sport-utility vehicles caught on and soccer moms started driving pickup trucks. So, while consumers responded less to high energy prices than conventional economics predicted before Katrina, they may respond more than expected now. Will Americans increasingly conserve energy after Katrina? "Emphatically yes, we will," says Cornell University economist Robert H. Frank.

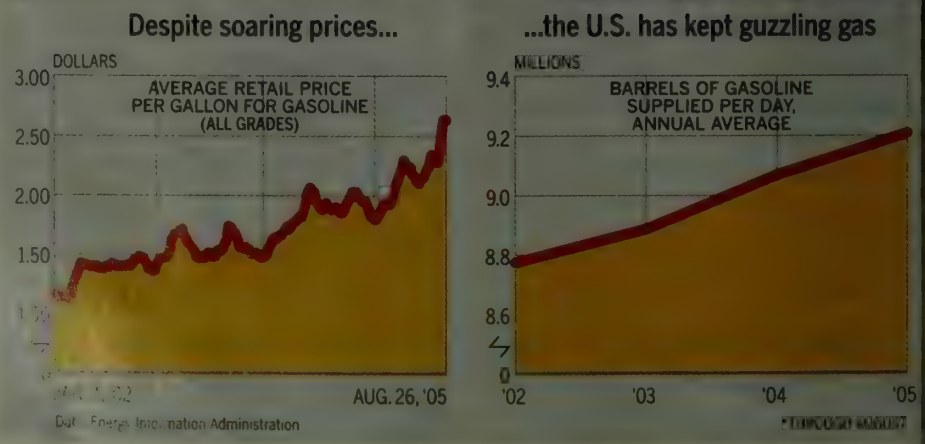
The evidence of Katrina's impact is already coming in. In the first report on post-Katrina auto sales, J.D. Power & Associates said on Sept. 7 that large SUVs and pickups together accounted for 38% of retail sales on Aug. 31, vs. an average of 46% in the first week of the month. At the same time, fuel-efficient vehicles have flown out of showrooms: One week into the month, five Honda dealerships in the Philadelphia area were completely sold out of hybrid Civics and were running low on conventional Civics with good mileage ratings. Wal-Mart Stores Inc. said Sept. 7 that it saw a post-Katrina pickup in sales of compact fluorescent light bulbs—sales that clearly weren't related to rebuilding from the hurricane.

TIPPING POINT

THE CRISIS-BORN urge to conserve makes sense to Cornell's Frank and other experts in the emerging field of behavioral economics. To them, people aren't merely rational calculators of self-interest, as traditional economics maintains, but emotional beings pushed and pulled by everything from procrastination and myopia to fear and anger. Given the choice, human nature tends to sit tight. People procrastinate about annoying energy-saving tasks like adding insulation, replacing leaky windows, or changing the air filter on their car, alone big steps like switching to a veh that gets better mileage or hooking with a carpool. They also tend to short-sighted, focusing on the near-te costs of energy-efficient technologie like expensive compact fluorescent rather than the long-term benefits. H prices alone don't always galvanize p ple into action.

But the shock of Katrina may be a ping point, forcing many consumers of the status quo. "For a long time were below the threshold of awareness energy. We're now crossing that thresh of visibility, and that's showing up in

A GROWING APPETITE FOR ENERGY



STICKER SHOCK Many began rethinking big cars after gas went over $3

nsumer reaction," says Peter J. Garrth, the principal of Garforth Internaonal LLC, an energy productivity conltancy based in Toledo.

Spot checks across the country reveal a ew of converts to conservation in recent ays. In Oxford, Miss., which was mostly ared by the hurricane, Kalyna Bullard d her husband, Mercer, are insisting at their plumber take back an ineffient water heater that he delivered to eir front porch while they were away d replace it with one that uses less engy. In Mullica Hill, N.J., Bill Madara, , and his wife, Cindi, 42, have decided spend $20,000 on a solar installation provide electricity, but not heat, for eir home. "The latest jump in oil ices really tipped the balance," says ill. In Bismarck, N.D., some pleasure oaters are putting their vessels in dryck early and don't plan to take them t next season, says Bob Gibbons, own- of Gibbons Fiberglass & Aluminum oat Repair. Gibbons himself is thinking out wearing sweaters more this win-r—and maybe getting his delivery uck to run on diesel derived from used oking oil.

Katrina may accelerate changes that ere likely to occur anyway. Even before e hurricane hit, some signs had already merged that consumers' buying patterns d begun to change. Prices of used SUVs, for example, had started to soften before the hurricane. That's key, because demand for used vehicles is a better indicator of what consumers really want than sales volumes for new vehicles, which are distorted by incentives. In the resale market, prices of large SUVs fell 5% and prices of large pickup trucks fell nearly 4% in August from a year earlier, while prices of compact cars rose 10%, according to Tom Webb, chief economist for Atlanta-based Manheim, the nation's largest clearinghouse for used vehicles. And even before Katrina, hybrid vehicles had gained so much cachet that in focus groups two-thirds of owners of the hybrid Lexus RX 400h SUV said they wanted more of an indication that the vehicle is a hybrid than the whisper-subtle "h" at the end of the vehicle's name.

Katrina may have sent consumers, rationally or not, across the threshold of energy awareness. Sales of fuel-efficient cars are up already

Now, the trend away from gas guzzlers appears to be picking up speed. Efficiency-minded car shoppers, for instance, were out in force over the Labor Day weekend. "My next car is going to be a hybrid or a car that has higher mileage per gallon," said Patricia Chavez-Dietz, 41, of Atlanta, who was shopping for a car for her daughter. Jennifer Meinel, a 28-year-old consultant in Reston, Va., says she's planning to replace her '95 Toyota Tacoma pickup with a compact car. Having run the numbers on fuel economy, she's leaning toward a Mini Cooper. Says Meinel: "I just don't like the idea of throwing money down the tank."

SAFETY IN BIGGER CARS

SOME OF THE effects of Katrina, of course, will wear off as gasoline prices retreat and the disaster gradually disappears from the evening news. Even with events on the Gulf Coast still unfolding, there are plenty of shoppers out looking for heavy metal. For some, the unfashionableness of a big vehicle continues to be trumped by the fear of getting crushed to death in a smaller one. Susan Hartzler, president of Hartzler Public Relations in Los Angeles, bought a Land Rover LR3 over the holiday weekend. Hartzler believes that the SUV she was driving last year saved her life in a freeway accident. "I feel safer in big cars," she says. "I know it's not very PC." And for many upper-income people, even today's high energy prices are nowhere near the choke point. "It's a problem for those who perceive it to be a problem, I guess," says Guy Milliken, 51, of Norcross, Ga., who says fuel efficiency isn't an issue for him in auto purchases. "We're fine," he says. "We don't use things wastefully."

For many Americans, though, Katrina and its impact on the energy markets was undoubtedly a landmark event, raising deep-seated fears about energy security in the same way that September 11 raised lasting fears about terrorist attacks on American soil. Says Cornell's Frank: "Energy is suddenly pretty high on the mental agenda."

It's enough to make you wonder: Is conservation coming back into style? If Birkenstocks can be cool again, why not energy conservation? ■

–By Peter Coy in New York, with David Welch in Detroit, Lauren Young in New York, Rishi Chhatwal in Atlanta, Dave Lindorff in Philadelphia, and bureau reports

FUMING Union workers in Oklahoma City protest prices

MARKETS

JUST MAKING AN HONEST BUCK?

Profiteering charges are flying, but retailers must often pass on high prices

WHILE FEDERAL rescuers needed days to mobilize after Hurricane Katrina tore through the Gulf region, another group was on the scene almost immediately: profiteers. In Mississippi, state officials say a couple from Indiana rolled into Jackson and began selling $700 generators out of a horse trailer for as much as $2,600. In Texas, officials are probing complaints that some budget motels charged refugees from Louisiana up to $300 a night—six times the normal rate. And the price-gouging wasn't limited to the Gulf region: With Katrina sending wholesale gas prices soaring, some stations as far away as Atlanta jacked up retail prices to as high as $6 a gallon.

Every time a hurricane or other disaster hits, the debate begins anew: Are rising prices a function of supply and demand or are they the result of price-gouging? Most Americans believe the latter; with gas prices up 17%, to top $3.00 a gallon on average since the hurricane hit, some 79% of respondents to a Gallup poll conducted on Sept. 5 and 6 said gasoline sellers were exploiting Katrina to charge unfair prices.

The public mood prompted some members of Congress to demand a national anti-gouging law. While that's unlikely, various states have already enacted such legislation. And the latest outbreak of price hikes has officials from California to the Katrina-stricken region pledging to crack down before gas costs spiral out of control. Vows Mississippi Attorney General Jim Hood: "I'm going to send some people to the penitentiary before this is over."

Perhaps. But proving that someone is profiteering is harder than it might seem. To make a case, investigators usually compare the price an alleged gouger is charging for essential commodities with the price 30 days before a state of emergency is declared. If the price rises sharply during the period, the merchant must prove that he or she maintained roughly the same profit margin as before—and that the price increase was the result of wholesale costs. In Florida, Attorney General Charlie Crist says that in "about 95%" of the complaints received by consumers, retailers were able to demonstrate that their wholesale costs had risen.

THE STAT

$6

PER GALLON

The highest reported post-Katrina gas price, nearly twice the national average

PANIC BUYING

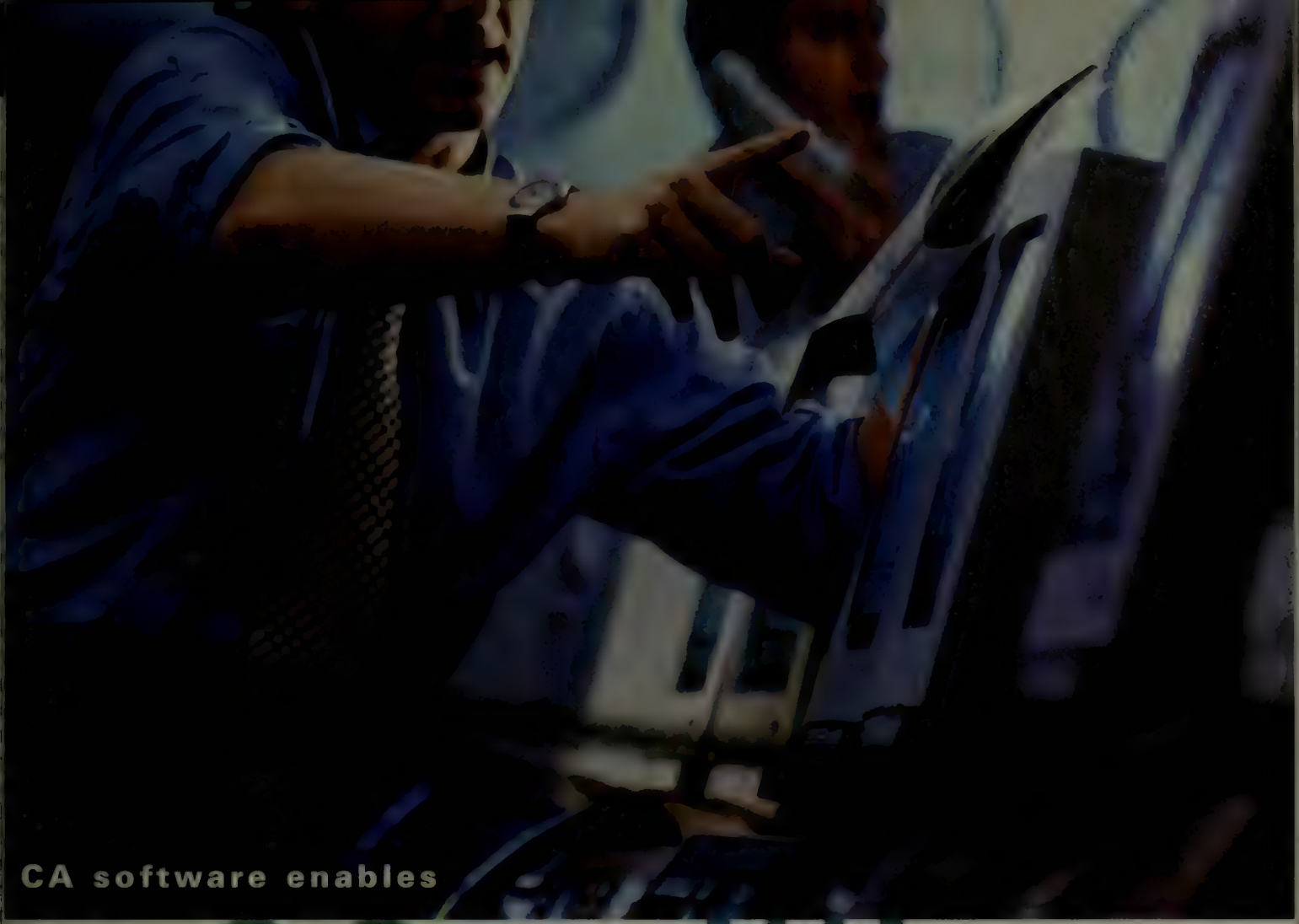
THAT HAS CERTAINLY BEEN the case this time with plywood, which soared nearly 20% in commodity markets. Some homebuilders and distributors raced to lock in supplies ahead of an anticipated rebuilding of New Orleans. "It's not so much profiteering as panic buying out of fear there will be shortages later on," says Michael Carliner, an economist for the National Association of Home Builders.

And for all the outcry about soaring gas prices, some industry experts say state investigators will have a hard time bringing profiteering charges against gas stations. They note that many independent retailers, which make up the vast majority of stations, are subject to complex contracts in which they're charged the daily wholesale price. To maintain their own profit margins, they must raise prices as soon as wholesale prices start rising, even for gasoline that's already on hand.

Moreover, as upset as consumers are getting, the market seems to be working. Tom Kloza, chief oil analyst for Oil Price Information Service, a Rockville (Md.) information service, notes that wholesale prices surged from the equivalent of $1.90 the Friday before Katrina hit to as much as $3.10 a gallon the Wednesday after. Add transportation costs, state and local taxes, the 2.5% credit-card processing charge, and the 5% to 10% markup that many retailers earn on gas sales, and that works out to between $3.70 and $3.90 a gallon—in line with what some stations were charging in high-cost markets.

With wholesale gas prices for October delivery falling to $2.05 per gallon on Sept. 7, motorists should be seeing some relief at the pump. If not, state officials will be apt to show no mercy. ■

–By Dean Foust in Atlanta



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MEDIA

A HURRICANE OF CRITICISM

For the world, the debacle shocks, surprises, and reveals

"Third World America."

–Daily Mail, Sept. 3, Britain

The headline from the right-leaning tabloid on Sept. 3 was typical of the reaction from the British, who in many ways have been the most outraged. The Brits have lambasted their American cousins for failing on every front, and followed events on the Gulf Coast more closely than other foreign media. "Has the myth of the 'can-do' U.S. ever been more shockingly exposed?" a *Daily Mail* editorial asked. "From the world's only superpower that can send shuttles into space and militarily pulverize nations within days, we are witnessing the impotence of a Third World c try to a catastrophe on its doorstep." The virulence of the reaction be due to the closeness of the British-U.S. relationship: No one lik see a close friend fail so miserably. The reaction also ties into the r tide of disgust at the war in Iraq—a war that many think Prime Mir Tony Blair was duped into supporting, a war that now even the us pro-American Tories have started to criticize.

"They sank."

–Vremya Novostei, Sept. 5, Russia

The rest of the headline explains: "Bush's image has dived to the bottom along with New Orleans." The paper echoes Vladimir V. Putin's comment after the sinking of the submarine Kursk in 2000. The reference to Putin's low point is part of the feeling that America has slid closer to Russia's level. That perception may make it easier for Russia to be friendly with the U.S., says Victor Kremenyuk, deputy director of the Institute for U.S.A. & Canada Studies: "Now the Russians may say, 'of course the Americans are great—but not that great.'"

"The Superpower is forced to call for help."

–Le Figaro, Sept. 3, France

The French have contrasted America's eagerness to project power abroad—as in the war that France opposed—with its failure to fix problems at home. "Is powerful Am more sure of itself outside its borders?" asked an editorial in the right-leaning *Le Figaro*.

The French have also focused on race. "It confirms many of the worst stereotypes we about the U.S.—that it is a racist country, and that the U.S. has perverted priorities," says D Lacorne, senior associate at the Center for International Studies & Research in Paris. "Ins of sending teams of doctors and nongovernmental organizations—they sent [the] Nati Guard." The French, who are proud of their welfare state model, also attribute the disast part to Bush Administration's free-market credo: Washington just doesn't have much fai government's ability to solve problems.

"The Day the U.S. Couldn't."

–Reforma, Sept. 5, Mexico

In his syndicated column, Jorge Ramos wrote: "The U.S. is realizing, for the first time since the fall of the Berlin Wall...that it cannot always win." Twenty years ago, 10,000 died in a Mexico City earthquake that exposed the government's incompetence. To see the same scenario unfold in *El Norte* is a shock. "We look at what's happening and say, 'My God, they're just like us,'" says political scientist Federico Estévez.

"Disaster Zone."

–Times of India, Sept. 4, Indi

"What is more surprising is that New Orleans...should have bee lowed to turn into Baghdad," says the *Times* editorial. To Indi who have had their share of violence and who see the U.S. as an ally in war on terror, Katrina proves that the U.S. is not ready for a new terr attack. Another issue: This summer, floods killed more than 1,00 Bombay. "But Bombay had no riots, no stealing, despite having the sa infrastructure shock," says Surjit Bhalla, managing director of Oxus search in New Delhi. ■ *–By Laura Cohn, with bureau rep*

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THE SUPREME COURT

WHY NOT SCALIA

The pugnacious darling of the Right was sidelined by the political calculus

WHEN GEORGE W. Bush visited the Supreme Court Sept. 6 to pay last respects to Chief Justice William H. Rehnquist, he was escorted into the Court's Great Hall by the man many conservatives believed would replace Rehnquist, propelled to the top job by sheer force of will and intellect: Justice Antonin Scalia.

Both men kept their thoughts to themselves, but the appearance was poignant. Just a day earlier, the President surprised Washington and many of his conservative allies by tapping Judge John G. Roberts Jr. of the U.S. Court of Appeals for the District of Columbia to serve as Chief Justice, thereby avoiding what would have been a nasty political fight over Scalia's nomination. Many court watchers hailed the move as a shrewd gambit by a President who finds himself at political low ebb. But hardliners didn't join in the jubilation. "We were hoping the President might elevate someone like Scalia," said Tony Perkins, president of the conservative Family Research Council.

Perkins & Co. had every reason to believe Scalia was a top contender. On the campaign stump, Bush repeatedly vowed to fill Supreme Court vacancies with judges "in the mold of Scalia" or Justice Clarence Thomas, meaning strict constructionists who favor a literal reading of the text of the Constitution. Bush's promises—he even declared Scalia to be his favorite jurist—combined with a year-long charm offensive by the usually irascible Scalia, led many to believe that the famously argumentative justice had a good shot to replace Rehnquist. After all, Scalia ranks alongside Rehnquist as one of the key intellectual architects of contemporary conservative legal philosophy. Both men fought lonely battles against the prevailing liberal jurispudence in the 1960s and 1970s, lived long enough to see their principles prevail over the past two decades—and became heroes to the Right.

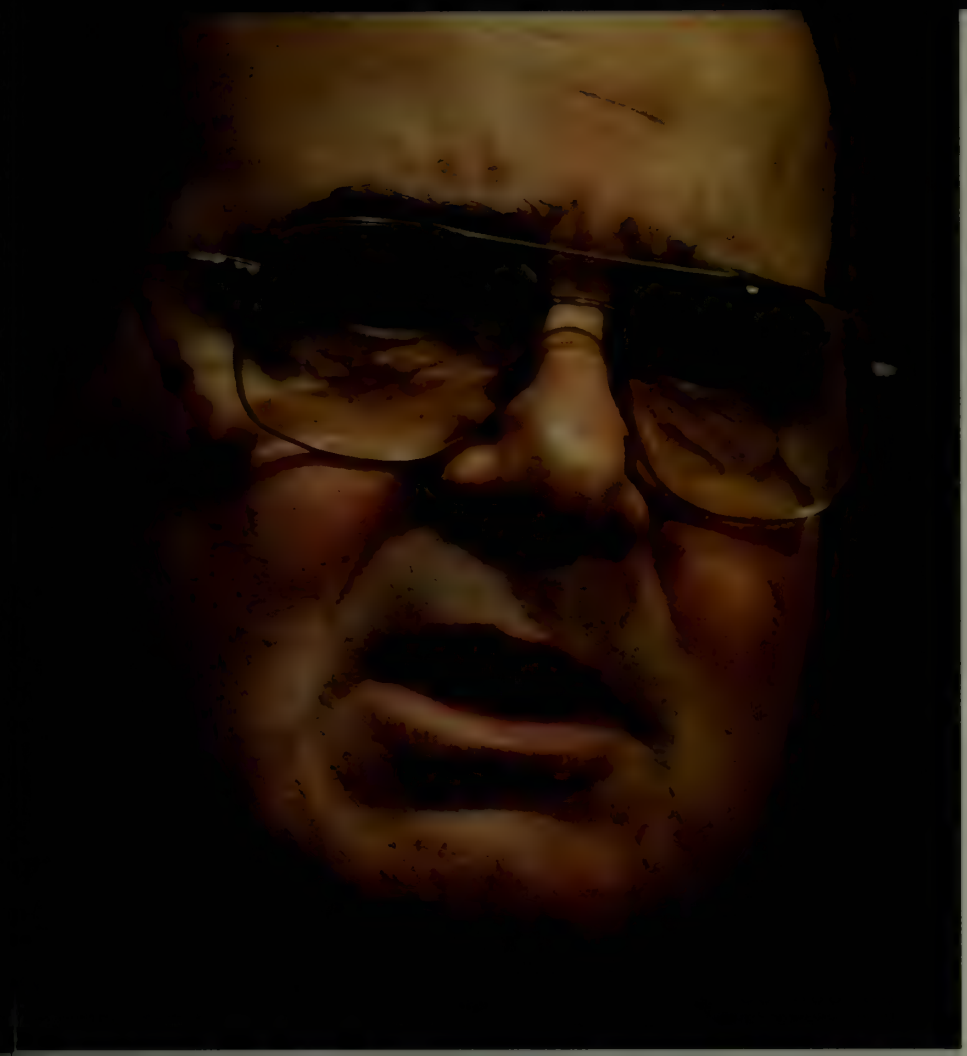
"Roberts' personality might be better for forging majorities"

–Stanton D. Anderson, U.S. Chamber of Commerce

In fact, the 69-year-old Scalia was never on the short list, say sources close to the White House. His age, combined with his combative personality, a ra controversial opinions, and the messy alities confronting a politically weake President, conspired against him. making Roberts chief, Bush has to g the Senate for confirmation only twi once each to replace Rehnquist and r ing Justice Sandra Day O'Connor, but the third time that would have been quired to O.K. Scalia's elevation to the spot. With Bush's approval ratings a all-time low, the President seems ill clined to risk his limited political cap on a knockdown struggle over Scalia.

On a practical front, Scalia's age sented a big negative to Bush, who is e to leave a generational imprint on

The Strikes Aga
Justice Scalia
Bush repeatedly promised name high court justices "i mold of Scalia." Yet Scalia even make his short list to vacancy left by Chief Justic William Rehnquist. Here's w



69, Scalia is too old. Bush ermined to meone who tay on the r the long d leave a mark.

TEMPERAMENT Scalia has a well-deserved reputation for brilliance, but he also is cantankerous and acerbic, qualities that might have hindered his ability to develop unified majorities.

POLITICS Under fire in the wake of Hurricane Katrina, Bush has limited political capital to spend on a controversial nominee. Scalia's opinions over 19 years on the high court would have handed his critics a lot of ammo.

HILL LOGISTICS Naming Scalia would have forced the Senate to confirm three appointments —his and two new Justices'. That would have given foes another chance to rally against Bush and overload a Congress focused on Katrina relief.

urt. At 50, Roberts is 19 years Scalia's nior and would be the youngest Chief stice since President John Adams ap-inted 45-year-old John Marshall to the urt in 1800. "I don't think there's any-ing that could have overcome that," says endy Long, counsel for the Judicial nfirmation Network, a group lobbying behalf of Bush's nominees. "If age eren't a factor, nothing else would have led [Scalia] out." While Scalia's plain-oken style has made him a darling of nservatives—he once called an O'Con-r argument "incoherent"—the modern-y federalist movement has spawned nu-erous Scalia-clones who can take up the dgel against the Welfare State. Among them: federal appeals court judges Priscilla Owen and J. Michael Luttig.

Compounding the problem with a Scalia nomination: his diplomacy on the court—or lack thereof. The pugnacious jurist might simply have pontificated his way out of the job. Almost no one on the high court has been spared his short temper and biting pen, which he has used frequently to criticize his colleagues. "Bush had been told by the legal community that Scalia would not have been an effective Chief [Justice]," says Stephen Hess, a former Ford Administration official. Roberts, in contrast, is a smooth and genial jurist already well liked by the justices. Says Stanton D. Anderson, executive vice-president of the U.S. Chamber of Commerce: "Roberts' personality might be better for forging majorities."

TOO OUTSPOKEN Scalia has long been a lightning rod for liberals

Adding to the Roberts juggernaut are the White House's political woes. Voters' unhappiness with Bush's halting response to Hurricane Katrina and the pace of the war in Iraq has discouraged the President from risking a prolonged Supreme Court confirmation battle. "Scalia has raised a lot of hackles," says Robert H. Bork, whose Supreme Court nomination was rejected amid bitter partisan warfare in 1987. Compared with Roberts, "the campaign against him would have been much more hysterical."

GRASSROOTS CAMPAIGN

THAT'S NOT TO SAY that Roberts will get a free pass. Within hours of his nomination, the Left tried to wrest the advantage, alerting the White House that Roberts' confirmation should be part of a package deal that would include a legal pragmatist to replace the swing-voting O'Connor. "Before the Senate acts on John Roberts' new nomination, we should know even more about his record, and we should know whom the President intends to propose to nominate as a replacement for Sandra Day O'Connor," said Senator Edward M. Kennedy (D-Mass.), a member of the Senate Judiciary Committee.

Bush followed his own counsel in picking Roberts, so don't count on him to take Kennedy's thoughts under serious advisement. But while the President contemplates his next move, conservatives are taking no chances. They calculate that Roberts, despite winning kudos from across the political spectrum, will face significant opposition—as many as 40 votes—from Democrats who will find a reason to vote against him on the floor to satisfy their liberal constituencies. As confirmation hearings get under way on Sept. 12, Roberts' backers will whip up grassroots support by flooding the airwaves in half a dozen states. Their message: The Supreme Court is the last defender of property rights, religious freedom, and traditional marriage.

For many movement conservatives, Scalia's thunderous orations and incendiary writings from the bench made him the ideal Chief Justice to press the campaign for limited government and traditional values. But in the end, the combative Scalia left the path open for Roberts, a man with seemingly no rough edges. ■

–By Lorraine Woellert, with Richard S. Dunham, in Washington

TELECOM

APPLE'S PHONE ISN'T RINGING ANY CHIMES

It certainly doesn't threaten the iPod—and that may be just what Jobs wants

APPLE COMPUTER INC. has made more than its share of epic moves. It kick-started the modern PC era with the Mac in 1984. It offered a vision of the handheld future with its ill-fated Newton in 1993. And in recent years it cracked the code on how to sell music in digital form via its iPod music player. So expectations were high when Apple, on Sept. 7, took the wraps off its first offering for one of tech's hottest markets: cell phones.

But the first iTunes phone, in many ways, is underwhelming. Officially called the Rokr and made by Motorola Inc., it's a silver-and-pearl-white device modeled on an existing Motorola phone. Press a button, and the familiar Apple interface appears on the screen. The unit—available exclusively from Cingular Wireless for $249, with a two-year contract—holds just 100 songs. That compares with more than 1,000 for phones from Nokia Corp. and Samsung. And while other phones can download the latest White Stripes or Beyoncé tune over the airwaves from anywhere, the iTunes phone has to be synched to a PC to get fresh music, just like the iPod.

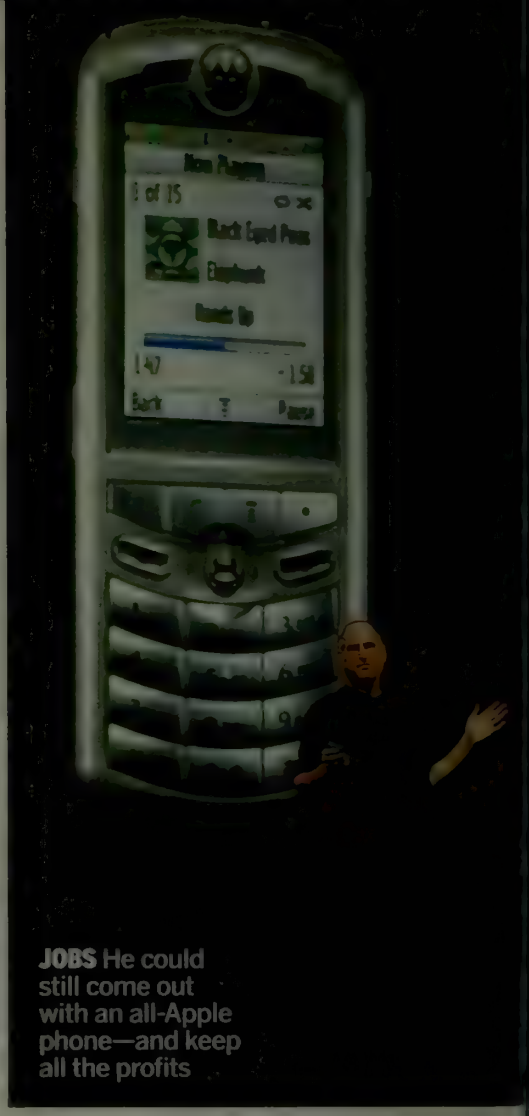
Even CEO Steven P. Jobs seems less than enthusiastic. At a star-studded press conference in San Francisco, he spent more time raving about Apple's new Nano, a pencil-thin addition to the iPod line that can hold 1,000 songs. He called it "the biggest revolution since the original iPod," while he deemed the Motorola phone "pretty cool."

Did Apple's designers suffer a rare brain cramp? Not likely. Rather, it looks like Jobs is making a careful gamble. He doesn't want the music-phone market to soar, at least not right away. That could cut into his iPod franchise, the source of almost all his revenue and profit growth. At the same time, he knows the mobile-phone market could be tremendously important for digital music in the future. So he's positioning Apple to be ready for a sales boom without leading the charge himself. "They don't want to cannibalize their business," says analyst Gene Munster of Piper Jaffray Cos. They just want "to give people a little taste."

Jobs, in other words, seems to be trying to define the music phone to his advantage. Phones such as those from Nokia and Samsung will rival the iPod as the device to carry all your music. But the iTunes phone is designed to be an accesso the iPod rather than a replacement. I use the same iTunes software the does but will carry only a fraction o number of songs. "They have to be as themselves: 'How can we stem or sto erosion [to mobile phones]?'" says D Frerichs, U.S. general manager for Co Technologies, a Swedish company tha velops music-compression techno "They could try to set a standard o pectations in everyone's minds phones can only get a small numb songs, so they aren't your music arch

Jobs's hesitance is understanc since anything that messes with the formula is bad for Apple. Sales of its ous iPod models are expected to hit billion this year, up from $2.3 billi 2004. A rush to music phones could future growth.

But Jobs's approach comes with risks. While he dabbles, he takes chance that a rival could come up w blockbuster hit, undercutting Ap ability to make iTunes a dominant dard in this growing market. And th no doubt the competition is cor



JOBS He could still come out with an all-Apple phone—and keep all the profits

How to Carry a Tune

A look at several mobile phones that can play music:

Apple's iTunes Phone
Capacity: **100 songs** Size: **3.8 oz.**
Cool? Yes. But limited capacity could crimp appeal.

Sony Ericsson's W800 Walkman
Capacity: **125 songs** Size: **3.5 oz.**
Sleek design gives new life to Walkman franchise.

Nokia N91
Capacity: **3,000 songs** Size: **5.6 oz.**
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That's another conversation you need to have with your doctor. Your doctor will decide the best course of treatment for you after assessing your particular needs.

Get more information about CRESTOR.

To learn more about CRESTOR, or if you are without prescription coverage and can't afford your medication, AstraZeneca may be able to help. Call 800-CRESTOR or visit CRESTOR.com.

Here is important safety information about CRESTOR you need to know.

CRESTOR is prescribed along with diet for lowering high cholesterol and has not been determined to prevent heart disease, heart attacks, or strokes. CRESTOR is not right for everyone, including women who are nursing, pregnant, or who may become pregnant, or anyone with liver problems. Your doctor will do blood tests before and during treatment with CRESTOR to monitor your liver function. Unexplained muscle pain and weakness could be a sign of a rare but serious side effect and should be reported to your doctor right away. The 40-mg dose of CRESTOR is only for patients who do not reach goal on 20 mg. Be sure to tell your doctor if you are taking any medications. Side effects occur infrequently and include muscle aches, constipation, weakness, abdominal pain, and nausea. They are usually mild and tend to go away.

If your doctor says, "lower is better," aim lower with CRESTOR.

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*Adult Treatment Panel (ATP) III, Update, 2004

Please read the important Product Information about CRESTOR on the adjacent page and discuss it with your doctor.

AstraZeneca

Please read this summary carefully and then ask your doctor about CRESTOR. No advertisement can provide all the information needed to determine if a drug is right for you.
This advertisement does not take the place of careful discussions with your doctor. Only your doctor has the training to weigh the risks and benefits of a prescription drug.

BRIEF SUMMARY: For full Prescribing Information, see package insert. **INDICATIONS AND USAGE** CRESTOR is indicated: 1. as an adjunct to diet to reduce elevated total-C, LDL-C, ApoB, nonHDL-C, and TG levels and to increase HDL-C in patients with primary hypercholesterolemia (heterozygous familial and nonfamilial) and mixed dyslipidemia (Fredrickson Type IIa and IIb). 2. as an adjunct to diet for the treatment of patients with elevated serum TG levels (Fredrickson Type IV). 3. to reduce LDL-C, total-C and ApoB in patients with homozygous familial hypercholesterolemia as an adjunct to other lipid-lowering treatments (e.g., LDL apheresis) or if such treatments are unavailable. **CONTRAINDICATIONS** CRESTOR is contraindicated in patients with a known hypersensitivity to any component of this product. Rosuvastatin is contraindicated in patients with active liver disease or with unexplained persistent elevations of serum transaminases (see WARNINGS, Liver Enzymes). **Pregnancy and Lactation** Atherosclerosis is a chronic process and discontinuation of lipid-lowering drugs during pregnancy should have little impact on the outcome of long-term therapy of primary hypercholesterolemia. Cholesterol and other products of cholesterol biosynthesis are essential components for fetal development (including synthesis of steroids and cell membranes). Since HMG-CoA reductase inhibitors decrease cholesterol synthesis and possibly the synthesis of other biologically active substances derived from cholesterol, they may cause fetal harm when administered to pregnant women. Therefore HMG-CoA reductase inhibitors are contraindicated during pregnancy, and in nursing mothers. ROSUVASTATIN SHOULD BE ADMINISTERED TO WOMEN OF CHILDBEARING AGE ONLY WHEN SUCH PATIENTS ARE HIGHLY UNLIKELY TO CONCEIVE AND HAVE BEEN INFORMED OF THE POTENTIAL HAZARDS. If the patient becomes pregnant while taking this drug, therapy should be discontinued immediately, and the patient apprised of the potential hazard to the fetus. **WARNINGS Liver Enzymes** HMG-CoA reductase inhibitors, like some other lipid-lowering therapies, have been associated with biochemical abnormalities of liver function. The incidence of persistent elevations (>3 times the upper limit of normal [ULN] occurring on 2 or more consecutive occasions) in serum transaminases in fixed dose studies was 0.4, 0, 0, and 0.1% in patients who received rosuvastatin 5, 10, 20, and 40 mg, respectively. In most cases, the elevations were transient and resolved or improved on continued therapy or after a brief interruption in therapy. There were two cases of jaundice, for which a relationship to rosuvastatin therapy could not be determined, which resolved after discontinuation of therapy. There were no cases of liver failure or irreversible liver disease in these trials. **It is recommended that liver function tests be performed before and at 12 weeks following both the initiation of therapy and any elevation of dose, and periodically (e.g., semiannually) thereafter.** Liver enzyme changes generally occur in the first 3 months of treatment with rosuvastatin. Patients who develop increased transaminase levels should be monitored until the abnormalities have resolved. Should an increase in ALT or AST of >3 times ULN persist, reduction of dose or withdrawal of rosuvastatin is recommended. Rosuvastatin should be used with caution in patients who consume substantial quantities of alcohol and/or have a history of liver disease (see CLINICAL PHARMACOLOGY, Special Populations, Hepatic Insufficiency). Active liver disease or unexplained persistent transaminase elevations are contraindications to the use of rosuvastatin (see CONTRAINDICATIONS). **Myopathy/Rhabdomyolysis Rare cases of rhabdomyolysis with acute renal failure secondary to myoglobinuria have been reported with rosuvastatin and with other drugs in this class.** Uncomplicated myalgia has been reported in rosuvastatin-treated patients (see ADVERSE REACTIONS). Creatine kinase (CK) elevations (>10 times upper limit of normal) occurred in 0.2% to 0.4% of patients taking rosuvastatin at doses up to 40 mg in clinical studies. Treatment-related myopathy, defined as muscle aches or muscle weakness in conjunction with increases in CK values >10 times upper limit of normal, was reported in up to 0.1% of patients taking rosuvastatin doses of up to 40 mg in clinical studies. In clinical trials, the incidence of myopathy and rhabdomyolysis increased at doses of rosuvastatin above the recommended dosage range (5 to 40 mg). In post-marketing experience, effects on skeletal muscle, e.g. uncomplicated myalgia, myopathy and, rarely rhabdomyolysis have been reported in patients treated with HMG-CoA reductase inhibitors including rosuvastatin. As with other HMG-CoA reductase inhibitors, reports of rhabdomyolysis with rosuvastatin are rare but higher at the highest marketed dose (40 mg). Factors that may predispose patients to myopathy with HMG-CoA reductase inhibitors include advanced age (≥65 years), hypothyroidism, and renal insufficiency. Consequently: 1. Rosuvastatin should be prescribed with caution in patients with predisposing factors for myopathy, such as, renal impairment (see DOSAGE AND ADMINISTRATION), advanced age, and inadequately treated hypothyroidism. 2. Patients should be advised to promptly report unexplained muscle pain, tenderness, or weakness, particularly if accompanied by malaise or fever. Rosuvastatin therapy should be discontinued if markedly elevated CK levels occur or myopathy is diagnosed or suspected. 3. The 40 mg dose of rosuvastatin is reserved only for those patients who have not achieved their LDL-C goal utilizing the 20 mg dose of rosuvastatin once daily (see DOSAGE AND ADMINISTRATION). 4. The risk of myopathy during treatment with rosuvastatin may be increased with concurrent administration of other lipid-lowering therapies or cyclosporine (see CLINICAL PHARMACOLOGY, Drug Interactions, PRECAUTIONS, Drug Interactions, and DOSAGE AND ADMINISTRATION). **The benefit of further alterations in lipid levels by the combined use of rosuvastatin with fibrates or niacin should be carefully weighed against the potential risks of this combination. Combination therapy with rosuvastatin and gemfibrozil should generally be avoided. (See DOSAGE AND ADMINISTRATION and PRECAUTIONS, Drug Interactions). 5. The risk of myopathy during treatment with rosuvastatin may be increased in circumstances which increase rosuvastatin drug levels (see CLINICAL PHARMACOLOGY, Special Populations, Race and Renal Insufficiency, and PRECAUTIONS, General). 6. Rosuvastatin therapy should also be temporarily withheld in any patient with an acute, serious condition suggestive of myopathy or predisposing to the development of renal failure secondary to rhabdomyolysis (e.g., sepsis, hypotension, dehydration, major surgery, trauma, severe metabolic, endocrine, and electrolyte disorders, or uncontrolled seizures).** **PRECAUTIONS General** Before instituting therapy with rosuvastatin, an attempt should be made to control hypercholesterolemia with appropriate diet and exercise, weight reduction in obese patients, and treatment of underlying medical problems (see INDICATIONS AND USAGE). Administration of rosuvastatin 20 mg to patients with severe renal impairment (CL_{cr} <30 mL/min/1.73 m^2), resulted in a 3-fold increase in plasma concentrations of rosuvastatin compared with healthy volunteers (see WARNINGS, Myopathy/Rhabdomyolysis and DOSAGE AND ADMINISTRATION). The result of a large pharmacokinetic study conducted in the US demonstrated an approximate 2-fold elevation in median exposure in Asian subjects (having either Filipino, Chinese, Japanese, Korean, Vietnamese or Asian-Indian origin) compared with a Caucasian control group. This increase should be considered when making rosuvastatin dosing decisions for Asian patients (See WARNINGS, Myopathy/Rhabdomyolysis, CLINICAL PHARMACOLOGY, Special Populations, Race, and DOSAGE AND ADMINISTRATION). **Information for Patients** Patients should be advised to report promptly unexplained muscle pain, tenderness, or weakness, particularly if accompanied by malaise or fever. When taking rosuvastatin with an aluminum and magnesium hydroxide combination antacid, the antacid should be taken at least 2 hours after rosuvastatin administration (see CLINICAL PHARMACOLOGY, Drug Interactions). **Laboratory Tests** In the rosuvastatin clinical trial program, dipstick-positive proteinuria and microscopic hematuria were observed among rosuvastatin-treated patients, predominantly in patients dosed above the recommended dose range (i.e., 80 mg). However, this finding was more frequent in patients taking rosuvastatin 40 mg when compared to lower doses of rosuvastatin or comparator statins, though it was generally transient and was not associated with worsening renal function. Although the clinical significance of this finding is unknown, a dose reduction should be considered for patients on rosuvastatin therapy with unexplained persistent proteinuria during routine urinalysis testing. **Drug Interactions Cyclosporine:** When rosuvastatin 10 mg was coadministered with cyclosporine in cardiac transplant patients, rosuvastatin mean C_{max} and mean AUC were increased 11-fold and 7-fold, respectively compared to healthy volunteers. These increases are considered to be clinically significant and require special consideration in the dosing of rosuvastatin to patients taking concomitant cyclosporine (see WARNINGS, Myopathy/Rhabdomyolysis and DOSAGE AND ADMINISTRATION). **Warfarin:** Coadministration of rosuvastatin to patients on stable warfarin therapy resulted in clinically significant rises in INR (>4 baseline 2-3) in patients taking coumarin anticoagulants and rosuvastatin concomitantly. INR should be determined before starting rosuvastatin and frequently enough during early therapy to ensure that no significant alteration of INR occurs. Once a stable INR time has been documented, INR can be monitored at the intervals usually recommended for patients on coumarin anticoagulants. If the dose of rosuvastatin is changed, the same procedure should be repeated. Rosuvastatin therapy has not been associated with bleeding or with changes in INR in patients not taking anticoagulants. **Gemfibrozil:** Coadministration of a single rosuvastatin dose to healthy volunteers on gemfibrozil (600 mg twice daily) resulted in a 2.2- and 1.9-fold, respectively increase in mean C_{max} and mean AUC of rosuvastatin (see DOSAGE AND ADMINISTRATION). **Endocrine Function** Although clinical studies have shown that rosuvastatin alone does not reduce basal plasma cortisol concentration or impair adrenal reserve, caution should be exercised if any HMG-CoA reductase inhibitor or other agent used to lower cholesterol levels is administered concomitantly with drugs that may decrease the levels or activity of endogenous steroid hormones such as ketoconazole, spironolactone, and cimetidine. **CNS Toxicity** CNS vascular lesions, characterized by perivascular hemorrhages, edema and mononuclear cell infiltration of perivascular spaces, have been observed in dogs treated with several other members of this drug class. A chemically similar drug in this class produced dose-dependent optic nerve degeneration (Wallerian degeneration of retinogeniculate fibers) in dogs at a dose that produced plasma drug levels about 30 times higher than the mean drug level in humans taking the highest recommended dose. Edema, hemorrhage, and partial necrosis in the interstitium of the choroid plexus was observed in a female dog sacrificed moribund at day 24 at 90 mg/kg/day by oral gavage (systemic exposures 100 times the human exposure at 40 mg/day based on AUC comparisons). Corneal opacity was seen in dogs treated for 52 weeks at 6 mg/kg/day by oral gavage (systemic exposures 20 times the human exposure at 40 mg/day based on AUC comparisons). Cataracts were seen in dogs treated for 12 weeks by oral gavage at 30 mg/kg/day (systemic exposures 60 times the human exposure at 40 mg/day based on AUC comparisons). Retinal dysplasia and retinal loss were seen in dogs treated for 4 weeks by oral gavage at 90 mg/kg/day (systemic exposures 100 times the human exposure at 40 mg/day based on AUC). Doses ≤30 mg/kg/day (systemic exposures ≤60 times the human exposure at 40 mg/day based on AUC comparisons) following treatment up to one year, did not reveal retinal findings. **Carcinogenesis, Mutagenesis, Impairment of Fertility** In a 104-week carcinogenicity study in rats at dose levels of 2, 20, 60, or 80 mg/kg/day by oral gavage, the incidence of uterine stromal polyps was significantly increased in females at 80 mg/kg/day at

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systemic exposure 20 times the human exposure at 40 mg/day based on AUC. Increased incidence of polyps was not seen at lower doses. In a 107-week carcinogenicity study in mice given 10, 60, 200 mg/kg/day by oral gavage, an increased incidence of hepatocellular adenoma/carcinoma was observed at 200 mg/kg/day at systemic exposures 20 times human exposure at 40 mg/day based on AUC. An increased incidence of hepatocellular tumors was not seen at lower doses. Rosuvastatin was not mutagenic or clastogenic with or without metabolic activation in the Ames test with *Salmonella typhimurium* and *Escherichia coli*, the mouse lymphoma assay, and the chromosomal aberration assay in Chinese hamster lung cells. Rosuvastatin was negative in the *in vivo* mouse micronucleus test. In rat fertility studies with oral gavage doses of 5, 15, 50 mg/kg/day, males were treated for 9 weeks prior to and throughout mating and females were treated 2 weeks prior to mating and throughout mating until gestation day 7. No adverse effect on fertility was observed at 50 mg/kg/day (systemic exposures up to 10 times human exposure at 40 mg/day based on AUC comparisons). In testicles of dogs treated with rosuvastatin at 30 mg/kg/day for one month, spermatidic giant cells were seen. Spermatidic giant cells were observed in monkeys after 6-month treatment at 30 mg/kg/day in addition to vacuolation of seminiferous tubular epithelium. Exposures in the dog were 20 times and in the monkey 10 times human exposure at 40 mg/day based on body surface area comparisons. Similar findings have been seen with other drugs in this class. **Pregnancy** *Pregnancy Category X* See CONTRAINDICATIONS. Rosuvastatin may cause fetal harm when administered to a pregnant woman. Rosuvastatin is contraindicated in women who are or may become pregnant. Safety in pregnant women has not been established. There are no adequate and well-controlled studies of rosuvastatin in pregnant women. Rosuvastatin crosses the placenta and is found in fetal tissue and amniotic fluid at 3% and 20%, respectively, of the maternal plasma concentration following a single 25 mg/kg oral gavage dose on gestation day 16 in rats. A higher fetal tissue distribution (25% maternal plasma concentration) was observed in rabbits after a single oral gavage dose of 1 mg/kg on gestation day 18. If this drug is administered to a woman with reproductive potential, the patient should be apprised of the potential hazard to a fetus. In female rats given oral gavage doses of 5, 15, 50 mg/kg/day rosuvastatin before mating and continuing through day 7 postcoitus results in decreased fetal body weight (female pups) and delayed ossification at the high dose (systemic exposures 10 times human exposure at 40 mg/day based on AUC comparisons). In pregnant rats given oral gavage doses of 2, 20, 50 mg/kg/day from gestation day 7 through lactation day 21 (weaning) decreased pup survival occurred in groups given 50 mg/kg/day (systemic exposures ≥12 times human exposure at 40 mg/day based on body surface area comparisons). In pregnant rabbits given oral gavage doses of 0.3, 1, 3 mg/kg/day from gestation day 6 to lactation day 18 (weaning) exposures equivalent to human exposure at 40 mg/day, based on body surface area comparisons, decreased fetal viability and maternal mortality was observed. Rosuvastatin was not teratogenic in rats at ≤25 mg/kg/day or in rabbits ≤3 mg/kg/day (systemic exposures equivalent to human exposure at 40 mg/day based on AUC or body surface comparison, respectively). **Nursing Mothers** It is not known whether rosuvastatin is excreted in human milk. Studies in lactating rats have demonstrated that rosuvastatin is secreted into breast milk in levels 3 times higher than that obtained in the plasma following oral gavage dosing. Because many drugs are excreted in human milk and because of the potential for serious adverse reactions in nursing infants from rosuvastatin, a decision should be made whether to discontinue nursing or administration of rosuvastatin, taking into account the importance of the drug to the lactating woman. **Pediatric Use** The safety and effectiveness in pediatric patients have not been established. Treatment experience with rosuvastatin in a pediatric [illegible] limited to 8 patients with homozygous FH. None of these patients was below 8 years of age. **Geriatric Use** Of the 10,275 patients in clinical studies with rosuvastatin, 3,159 (31%) were 65 years and older, and 698 (6.8%) were 75 years and older. The overall frequency of adverse events were similar in patients above and below 65 years of age (See [illegible] rhabdomyolysis). The efficacy of rosuvastatin in the geriatric population [illegible] comparable to the efficacy observed in the non-elderly. **ADVERSE REACTIONS** [illegible] generally well tolerated. Adverse reactions have usually been mild [illegible] studies of 10,275 patients, 3.7% were discontinued due to adverse experiences with [illegible] rosuvastatin. The most frequent adverse events thought to be related to rosuvastatin were [illegible] constipation, asthenia, abdominal pain, and nausea. **Clinical Adverse Experiences** Adverse experiences, regardless of causality assessment, in ≥2% of patients in placebo-controlled clinical studies of rosuvastatin are shown. [illegible] discontinuations due to adverse events in these studies of up to 12 weeks duration occurred in [illegible] of patients on rosuvastatin and 5% on placebo.

Table 1. Adverse Events in Placebo-Controlled Studies

Adverse event	Rosuvastatin N=[illegible]	Placebo N=382
Pharyngitis	9.0	7.5
Headache	5.5	6.0
Diarrhea	3.[illegible]	2.9
Dyspepsia	3.[illegible]	3.1
Nausea	3.[illegible]	3.1
Myalgia	1.9	1.3
Asthenia	2.7	2.[illegible]
Back pain	2.5	2.4
Flu syndrome	2.3	1.8
Urinary tract infection	2.3	1.6
Rhinitis	2.2	2.1
Sinusitis	2.0	1.8

In addition, the following adverse events were reported, regardless of causality assessment, in ≥1% of 10,275 patients treated with rosuvastatin in clinical studies. The events in *italics* occurred in ≥2% of these patients. **Body as a Whole:** *Abdominal pain, accidental injury, chest pain, bon, pain,* pelvic pain, and neck pain. **Cardiovascular System:** *Hypertension,* angina, vasodilatation, and palpitation. **Digestive System:** *Constipation, gastroenteritis,* vomiting, [illegible]lence, periodontal abscess, and gastritis. **Endocrine:** Diabetes mellitus. **Hemic and L[illegible] System:** Anemia and ecchymosis. **Metabolic and Nutritional Disorders:** *Peripher[illegible]* **Musculoskeletal System:** *Arthritis, arthralgia,* and pathological fracture. **Nervous:** *Dizziness, insomnia, hypertonia, paresthesia, depression,* anxiety, vertigo, and [illegible] **Respiratory System:** *Bronchitis, cough increased,* dyspnea, pneumonia, and asthma. **Appendages:** *Rash* and pruritus. **Laboratory Abnormalities:** In the rosuvastatin clinical program, dipstick-positive proteinuria and microscopic hematuria were observed among rosuvastatin-treated patients, predominantly in patients dosed above the recommended dose range (80 mg). However, this finding was more frequent in patients taking rosuvastatin 40 mg when compared to lower doses of rosuvastatin or comparator statins, though it was generally transient, and was not associated with worsening renal function. (See PRECAUTIONS, Laboratory Tests.) Other abnormal laboratory values reported were elevated creatinine phosphokinase, transaminases, hyperglycemia, glutamyl transpeptidase, alkaline phosphatase, bilirubin, and thyroid function abnormalities. Other adverse events reported less frequently than 1% in the rosuvastatin clinical study program, regardless of causality assessment, included arrhythmia, hepatitis, hypersensitivity reactions (i.e., face edema, thrombocytopenia, leukopenia, vesiculobullous rash, urticaria, and angioedema), kidney failure, syncope, myasthenia, myositis, pancreatitis, photosensitivity reaction, myopathy, and rhabdomyolysis. **Postmarketing Experience** In addition to the events reported above, as with other drugs in this class, the following events have been reported during post-marketing experience with CRESTOR, regardless of causality assessment: very rare cases of jaundice. **OVERDOSAGE** There is no specific treatment in the event of overdose. In the event of overdose, the patient should be treated symptomatically and supportive measures instituted as required. Hemodialysis does not significantly enhance clearance of rosuvastatin. **DOSAGE AND ADMINISTRATION** The patient should be placed on a standard cholesterol-lowering diet before receiving CRESTOR and should continue on this diet during treatment. CRESTOR can be administered as a single dose at any time of day, with or without food. **Hypercholesterolemia (Heterozygous Familial and Nonfamilial) and Mixed Dyslipidemia (Fredrickson Type IIa and IIb)** The dose range of CRESTOR is 5 to 40 mg once daily. Therapy with CRESTOR should be individualized according to goal of therapy and response. The usual recommended starting dose of CRESTOR is 10 mg once daily. However, initiation of therapy with 5 mg once daily should be considered for patients requiring less aggressive LDL-C reductions, who have predisposing factors for myopathy (see WARNINGS, Myopathy/Rhabdomyolysis). **When initiating statin therapy or switching to another statin therapy, the appropriate CRESTOR starting dose should first be utilized, then titrated according to the patient's individualized goal of therapy. Homozygous Familial Hypercholesterolemia** The recommended starting dose of CRESTOR is 20 mg once daily in patients with homozygous FH. The maximum recommended daily dose is 40 mg. CRESTOR should be used in these patients as an adjunct to other lipid-lowering treatments (e.g., LDL apheresis) or if such treatments are unavailable. Response to therapy should be estimated from pre-apheresis LDL-C levels. **Dosage in Asian Patients** Initiation of CRESTOR therapy with 5 mg once daily should be considered for Asian patients. The potential for increased systemic exposures relative to Caucasians is relevant when considering escalation of dose, where hypercholesterolemia is not adequately controlled at doses of 5, 10, or 20 mg once daily (See WARNINGS, Myopathy/Rhabdomyolysis, CLINICAL PHARMACOLOGY, Special Populations, Race, and PRECAUTIONS, General). **Dosage in Patients Taking Cyclosporine** In patients taking cyclosporine, therapy should be limited to CRESTOR 5 mg once daily (see WARNINGS, Myopathy/Rhabdomyolysis, and PRECAUTIONS, Drug Interactions). **Concomitant Lipid-Lowering Therapy** The effect of CRESTOR on LDL-C and total-C may be enhanced when used in combination with a bile acid binding resin. If CRESTOR is used in combination with gemfibrozil, the dose of CRESTOR should be limited to 10 mg once daily (see WARNINGS, Myopathy/Rhabdomyolysis, and PRECAUTIONS, Drug Interactions). **Dosage in Patients With Renal Insufficiency** No modification of dosage is necessary for patients with mild to moderate renal insufficiency. For patients with severe renal impairment (CL_{cr} <30 mL/min/1.73 m^2) not on hemodialysis, dosing of CRESTOR should be started at 5 mg once daily and not exceed 10 mg once daily (see PRECAUTIONS, General, and CLINICAL PHARMACOLOGY, Special Populations, Renal Insufficiency).

NOTE: This summary provides important information about CRESTOR. For more information, please ask your doctor or health care professional about the full Prescribing Information. Discuss it with them.

Rx only

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Samsung, Sony, Nokia—they all have gnificant plans," says Alan R. cGlade, chief executive of MusicNet, a ovider of digital music technology.

Wireless carriers, which control the ones that get to market through their bsidies, aren't falling into line, either. ighty Verizon Wireless chose Sept. 6, e day before Jobs's keynote, to clarify s own digital-music plans, including veral new music phones and an over-e-air service that will debut later this ar. Sprint Nextel Corp. plans new hones and an over-the-air service that ill let customers buy music at a mo-ent's notice. "The capability [of the unes phone] is not that new," says aul S. Reddick, vice-president of busi-ess development and product innova-on at Sprint. "What we're talking out launching this year is new."

LENTY OF OPTIONS

HE MOBILE-MUSIC market may well ke off despite Jobs's measured sup-ort. Still, he has plenty of cards to play. ost intriguing are the licensing possi-lities. With the iTunes phone, Apple rovided its iTunes software and Fair-ay digital-rights management soft-are to Motorola, although how Apple compensated was not disclosed. If the ew phone becomes a hit, Jobs could ursue other deals, including licensing ftware to Motorola or another manu-cturer for a phone that could store ousands of songs.

Another path Jobs could take? He uld come out with his own cell phone, aving current partner Motorola be-ind. Piper Jaffray's Munster thinks ere's a 50% chance Apple will intro-ce its own phone in the next year. In a rvey of 200 people, 18% were inter-ted in buying an "iPhone" from Ap-le, Munster found. "People don't want Motorola-Apple phone. They want an pple phone," he says. "That's what our rveys show, and [Apple is] probably oing the same research we're doing."

Getting into the cell-phone business ese days is quite simple: There's no eed to master radio technology or build manufacturing plant since contract anufacturers such as Flextronics Inter-ational Ltd. or BenQ Corp. can handle l that. So Apple could keep all the prof-s—and the control to make a phone the ay it wants. A long shot? Perhaps. But 's one sure way Apple could make a real lash in the wireless industry. ■

–By Peter Burrows in San Francisco, with Roger O. Crockett in Chicago and Heather Green in New York

ADVERTISING

IS IPG WORTH THE SUM OF ITS PARTS?

Accounting woes nearly behind it, the ailing ad giant must now weigh a breakup

INTERPUBLIC GROUP OF COMPANIES Chief Executive Michael I. Roth has Sept. 30 circled on his calendar. That's the deadline for filing the ailing ad giant's long-delayed 2004 financial reports, or face a delisting by the New York Stock Exchange.

That would be a worse blow to Roth than the recent loss of Bank of America Corp.'s $600 million ad account. The defection followed a string of account losses on top of IPG's financial meltdown and a government probe into its accounting. Roth says he'll make his deadline. After that, he acknowledges he may have to defend keeping IPG whole against pressure to break it up. "Maybe that's an issue for us down the road," says Roth. "But right now, it doesn't make sense."

RICHER RIVALS

WITHOUT 2004 RESULTS IN, valuing IPG as the sum of its parts is tough. "They don't give us enough information to know the profitability of each agency," says Merrill Lynch & Co. analyst Lauren Rich Fine. Insiders say IPG's McCann Worldgroup is healthy, and its smaller units such as Draft and New York-based Deutsch make money, but Lowe & Partners and FCB Worldwide could drag the stock down for years. IPG closed at $11.77 on Sept. 7.

Making it especially tough for IPG is that rivals are doing much better. Omnicom shares trade at twice IPG's price-to-revenue ratio. Omnicom has acquired many agencies too, but, unlike IPG, has not merged a diverse group of large firms. Lowe, for example, had to digest four agencies, one after the other. "Those who fail in this business usually do so because they lose their culture," says Howard Draft, CEO of IPG's Draft.

IPG's woes stem from an acquisition spree in the late 1990s of more than 400 firms around the world. It even owned Formula One racetracks for a time. In those years, says Roth, IPG overpaid for many agencies and didn't accurately track their true profits.

CEO ROTH Despite losing big accounts, he wants to keep IPG intact

As chairman and then CEO, Roth has been cleaning house. IPG has restated earnings from 1996 to 2001, and will restate more this month. It has also taken almost $3 billion in write-downs and nearly $1 billion in restructuring. Meantime, it expects to bring in about $6 billion in revenues this year, helped by new global accounts with Intel and Nokia. But those big wins pale beside big losses from BofA, General Motors, and Samsung. Though some agency chiefs inside IPG say privately they would favor a breakup, Roth has supporters. "This is the horse I chose and the horse I have to ride," says Howard Draft. Would that clients were so loyal. ■

–By David Kiley in New York

EDITED BY MONICA GAGNIER

HEADLINER

GLENN TILTON

READY FOR TAKEOFF

Finally, an exit strategy for United Airlines. Nearly 32 months after Chief Executive Glenn Tilton put the carrier in Chapter 11 bankruptcy, United filed a reorganization plan on Sept. 7 to emerge by Feb. 1.

The plan, which still must be approved by creditors and a bankruptcy judge, relies on $2.5 billion in loans from a group that includes JPMorgan Chase and Citigroup. United might raise $500 million more by offering new shares to creditors. Since filing Chapter 11 in December, 2002, Tilton has slashed United's nonfuel spending by 18%, or $3 billion, by cutting jobs and wages, dumping pensions, and shrinking the domestic schedule. "We are now competitive with the best network carriers," Tilton, 56, told employees.

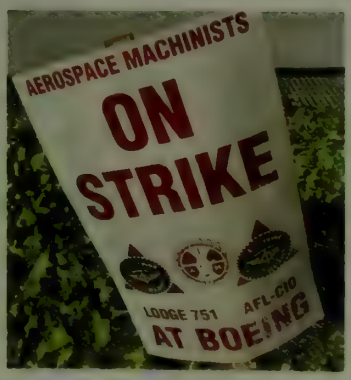
But with fuel prices at record highs, United is still losing money. So are most of its peers. Indeed, analysts are warning that Delta Air Lines and Northwest Airlines may end up in bankruptcy before United's exit, as higher fuel costs consume the savings generated by operations cutbacks.

–Michael Arndt

MORE GRIEF FOR KPMG

The hammer may be about to come down even harder on the individuals involved in accounting giant **KPMG's** sale of four controversial tax shelters between 1996 and 2002. A government prosecutor says the Justice Dept. expects to charge at least 12 more individuals in the case. The prosecutor would not say who else would be indicted, but they could include KPMG partners, bankers, and lawyers involved in the deals. On Aug. 26, a grand jury indicted eight former KPMG partners as well as an outside lawyer for their role in selling the shelters and for allegedly lying to the Internal Revenue Service about the deals. The lawyers for the defendants denied the charges. KPMG agreed to pay $456 million in penalties, stop selling the shelters, and cooperate with Justice. In return, the feds agreed to delay charges against the firm for a year.

A BURDEN FOR BOEING



The strike by **Boeing's** Machinist Union is about to get costly for the Chicago aerospace giant. If the five-day-old strike continues for a month, it would delay the delivery of about 33 aircraft, or 40% of the anticipated production for the third quarter. According to Wall Street analysts, the delivery delays would cost Boeing about $97 million, or 12¢ a share, in the third quarter. A continued strike could cost Boeing more than $80 million a month. So far, neither the union nor Boeing management are talking. The 18,300 hourly production workers voted overwhelmingly to walk out on Sept. 1 over benefits that union leaders say fell far short of their demands.

ALNYLAM'S NEW ALLIANCE

Biotech up-and-comer **Alnylam Pharmaceuticals** got a big vote of confidence from **Novartis.** On Sept. 7, the Swiss pharmaceutical giant announced it will partner with Cambridge (Mass.)-based Alnylam to develop therapies based on RNA interference, a potentially promising approach of silencing disease-causing genes. The deal could funnel more than $700 million in payments to Alnylam, which saw its shares jump 43.8%, to $13.75.

FAREWELL TO THE SEC

Would the last senior staffer to leave the Securities & Exchange Commission please turn off the lights? The decision by SEC chief accountant Donald Nicolaisen to step down in October gives the agency's new chairman, Christopher Cox, another top slot to fill. Already, two of the SEC's four divisions—investment management and market regulation—are without a chief, and insiders expect Alan Beller, director of the Corporation Finance Div., to depart soon, too. The openings will let Cox resh the agency to his liking. In what could be his last offi act, Nicolaisen was expect on Sept. 8 to throw cold water on a method for valuing employee stock options proposed by **Cisco Systems.**

ET CETERA...

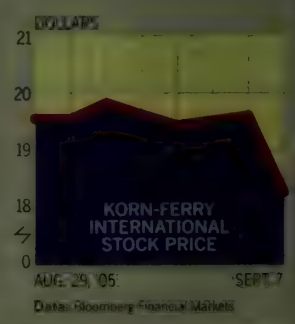
>> **BearingPoint** says the SE has launched a formal pro of its business dealings.

>> **Microsoft** filed a new appeal against the EU's March, 2004, ruling that i violated competition law.

>> **Ford Motor** is recalling nearly 4 million pickups a SUVs because of a faulty speed-control device.

CLOSING BELL

Executive recruiter Korn/Ferry International on Sept. 7 reported a 38% profit gain for its fiscal first quarter but cautioned that its talent searches slowed during the summer. Investors responded by knocking the search firm's share down 7%, to $18.2



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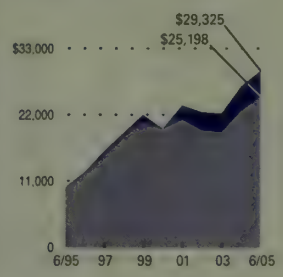
Performance

How $10,000 Invested 6/30/95 Would Have Grown vs. Competitors



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Average annual total return figures include changes in principal value, reinvested dividends, and capital gain distributions. *Lipper also ranked the fund #130 out of 223, #18 out of 130, and #11 out of 70 equity income funds for the 1-, 5-, and 10-year periods ended 6/30/05, respectively. **For funds with at least a 3-year history, a Morningstar Rating™ is based on a risk-adjusted return measure (including the effects of sales charges, loads, and redemption fees) with emphasis on downward variations and consistent performance. The top 10% of funds in each category receive 5 stars, the next 22.5% 4 stars, the next 35% 3 stars, the next 22.5% 2 stars, and the bottom 10% 1 star. Each share class is counted as a fraction of one fund within this scale and rated separately. Morningstar Rating™ is for the retail share class only; other classes may have different performance characteristics. The fund received 3, 4, and 4 stars for the 3-, 5-, and 10-year periods ended 7/31/05, respectively. ©2005 Morningstar, Inc. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete, or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. T. Rowe Price Investment Services, Inc., Distributor.

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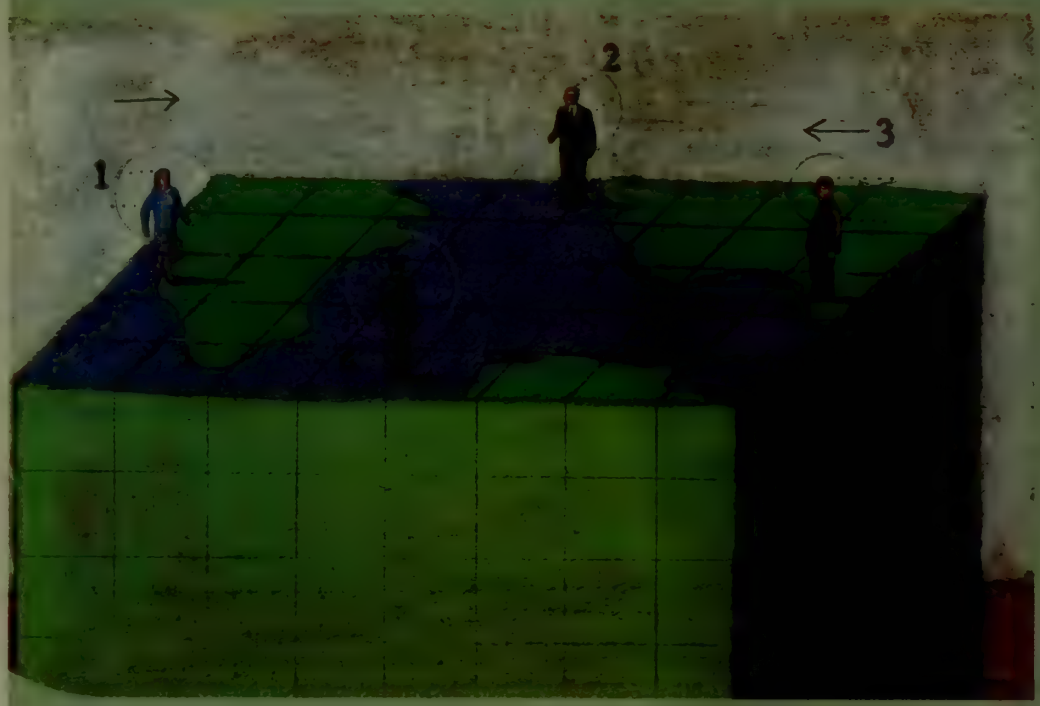
The Global Supply Chain

Discovering New Opportunity Across the "Flat World"



Ansell Healthcare isn't unusual in viewing new markets and global manufacturing as opportunities waiting to happen. Over the past several years, growing sales encouraged the company—which supplies barrier-protection products such as condoms and medical gloves – increasingly to shift its manufacturing operations to lower-cost facilities in Asia, while opening distribution centers in the U.S., Europe, and Australia. Yet the success of this strategy was accompanied by an astringent dose of reality: it turns out that globalization, with all its potential for revenue gains, can turn the shortest, most efficient and direct manufacturing supply lines into lengthy, tangled chains of business partners.

"Most of our products are sent on ships to distribution centers," says Ralph Johnson, vice president of IT for parent company Ansell Ltd., in Red Bank, N.J. "At any time, we have four to eight weeks of inventory on the water, and all shipments are processed through major ports. In order for our products to hit the distribution centers just as customers need them, we need to shorten our supply chain from order to ship and increase the accuracy of our forecasting and planning."

As Ansell learned, globalization has created a massive increase in the complexity of supply chains. "For years, companies have focused on lean manufacturing principles, just-in-time deliveries, minimal batches, and shorter lead times," says Andrew Kinder, product development director for Atlanta-based Infor. "It was all about getting manufacturing to be closer to the demand signal. But for companies like Ansell that are supplying domestic markets from offshore operations, it's going in reverse. They find themselves moving toward elongated supply lines, longer lead times, bigger batch sizes, and more inflexible delivery patterns."

According to author Thomas L. Friedman's new book, *The World is Flat*, competition and capability around the world are undergoing a great equalization process. One result is that complex supply chains are delivering products created through the use of labor and services available in emerging markets, such as India and China, and then leveraged through competitive commoditization strategies. Yet this very globalization and the accompanying economic successes are forcing many companies to rethink their supply-chain strategies and solutions.

When production and distribution operations are located around the world, the supply chain never rests.

Don't stop till you get enough

The fact is, when production and distribution operations are located around the world, the supply chain never rests. Communications are exchanged 24/7, processes and related problems occur around the clock, and solutions are required at every hour. Formerly discrete supply lines converge, highlighting the need for collaboration and coordination. "Globalization is increasing the need for planning and supply-chain visibility," explains Lora Cecere, research director at AMR Research Inc., in Boston. "Companies want to plan corporately for global coordination, then execute locally. To do this, they require richer functionality for sales and operations planning as well as improved supply-chain visibility."

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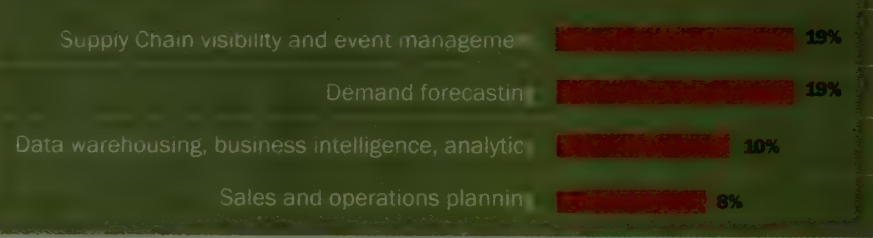
Early-warning signs, systems, and detection opportunities are basic equipment if companies want to understand—early—when there is a problem, so that it can be corrected quickly. "With offshore manufacturing, the most economical way to ship goods is by ocean, not air," states Jim Ritchie, president and CEO of Meridian IQ, the global logistics management company of Yellow Roadway Corp., in Overland Park, Kan. "But that creates a 17- to 23-day window from the time the product leaves the port in Asia to when it arrives in the U.S. If you find out only then that the product in the container is not what you requested, you are faced with a significant supply-chain problem that will affect your ability to satisfy your customers."

Companies that fail to enhance visibility along the supply chain can run into serious problems. The good news, according to Ritchie, is that such visibility technology is relatively simple to

Top-rated SCM investments for 2005

What do you feel will be the most important technology you will be considering to support your SCM initiatives?



Source: AMR Research 2004

build, use, and administer. Far more challenging are cultural and human issues. Taking care to develop relationships with offshore manufacturing personnel—which involves adequately training them to use the technology and helping them understand the cultural need to meet customer demand in a timely manner—is critical to developing cooperation and collaboration throughout the supply chain. "This is easy to do face to face, but much more difficult when you just issue written instructions that can be lost in translation both technically and culturally," says Ritchie. "Having a provider with a physical presence is the key to bridging the gaps between culture, collaboration, and technology."

This isn't what I ordered

One under-recognized component of visibility is the ability to gauge the impact of returned goods on the supply chain. Most manufacturers and distributors allow customers to return goods, but tracking data on the returns or analyzing returns trends is a skill many have not mastered.

"Brand owners must understand why items—be they capital or expensed—are returned," explains David Griffith, vice president of supply-chain management for the Americas for BAX Global Inc., an international logistics and supply-chain-management company, in Irvine, Calif. "Understanding these trends helps companies with their quality-control efforts and even their demand planning. Therefore, the returns' 'last mile' needs to become more sophisticated and more centralized, so that business decisions on scrapping or recovering products can be made more intelligently."

TIME IS MONEY

Supply-Chain Mana Get Smarter

The challenges posed by globalizat and economic expansion are cleari affecting corporate decision makin regarding supply-chain-managemer (SCM) strategies and technology. In recent survey of 200 companies at their planned SCM budgets, techno ogy investment priorities, and goals for this year and next, Boston-base AMR Research Inc. found that plan spending on SCM hardware, softwa and services is up, for the first time several years.

Approximately 47% of the responde plan a 6.4% increase in SCM spendir to support their demand-driven sup networks (DDSNs). The average buc get for a company with total annual revenue of more than $1 billion is expected to be $8.5 million this yea "Enterprises are dealing not so muc with supply chains, but with the syn chronization of business partners," says AMR Research's Lora Cecere. "This requires a focus on better unc standing customer demand, optimiz product launches, and managing ar extended network."

To support this need, companies are planning investments in supply-chai visibility, demand forecasting, data warehousing and analytics, and sale and operations planning. Interesting many of these supply-chain decision are being driven by line-of-business (LOB) managers, not the IT manager who had been responsible in the pa Those LOB departments are also pa ing for the new investments. In 200 AMR Research says, 40% of the SCM projects will be funded by supply-cha or sourcing departments.

Although nearly half the respondent anticipated buying their SCM techno ogy and services from an enterprise resource planning vendor, 26% said they will evaluate the use of hosted solutions. Surprisingly, 29% are consid ering developing their own software. "Commercially available software is often not meeting the needs of innovators," says Cecere. "For these companies, building their own is the preferred alternative."

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New Directions, Opportunities, and Challenges

Roundtable 2005

Eric Karofsky
AMR Research

John Boucher, Celestica

Chris Smith, RiverOne

Ray Homan, SAP

We've heard people talk about green supply chain issues as a Y2K-like issue.

ERIC KAROFSKY, senior research analyst, AMR Research: It's similar in that the deadline is forcing companies to react. However, with Y2K, once you solved it, you were done. With environmental compliance, it's Y2K over and over and over again. As environmental laws change, as we find out new information about hazardous materials, and most importantly, as public perceptions change and influence governments to act, we need to constantly re-qualify products that are entering the market.

How is compliance especially difficult for high-tech manufacturers?

CHRIS SMITH, president and CEO, RiverOne: Compliance is a challenge for all organizations, but high-tech manufacturers' extensive use of outsourcing creates an even larger challenge. Brand owners are trying to manage processes that they aren't even able to control directly, because they take place outside their four walls. So you have a dependence on partners and suppliers to achieve compliance, but ultimately the brand owner is responsible. That makes this a cross-supply-chain issue.

How prepared are high-tech manufacturers to meet compliance deadlines?

RAY HOMAN, senior vice president, SAP: Overall, I think we have a long way to go. When you work back from a compliance date, with an eye toward the process design changes required, the challenge is very significant. The added complexity of knowing that these regulations will change over time also requires an approach that supports the business mandate for adaptability and agility in your supplier relationships. Given that status and the corresponding level of effort required, the time to get started is now.

Do companies see compliance challenges in the same way?

SMITH: Definitely not. Consider material content declarations for Restriction of Hazardous Substances (RoHS) compliance. There's no consensus right now on how to implement this. Some companies are working to obtain declarations for every part from every supplier, while others are expecting to focus on non-compliant parts, the exceptions, only. Waste Electrical and Electronic Equipment (WEEE) is a more complex problem and implementation is more confused. Each country has a different scheme, timetable, and fee structure. Companies will be responsible for producing reports and paying fees based on their net shipments into each country.

JOHN BOUCHER, chief supply chain and procurement officer, Celestica: From a scope and complexity standpoint, this legislation will have a broad-reaching impact on us as a company. It will impact each of our suppliers and customers (even those OEMs with exemptions), as well as our own global manufacturing operations. We must be aware of each customer's plans for every one of their products we design or manufacture, and work closely with them and the extended supply base to migrate to an overall state of RoHS readiness. With over 200 customers, approximately 7,000 suppliers, and approximately 400,000 different component part numbers to procure and transform, I'm sure you can appreciate the scope of this task.

What are the most critical compliance challenges that companies are facing?

HOMAN: The product area is number one, because product drives the supply chain. This involves a multitude of activities, including the initial collection of supplier compliance declarations, the identification of critical components, and the subsequent engineering changes, if needed. The second

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area is the ongoing change management. High-tech companies live and thrive in a very agile and adaptive environment. Forward-looking companies will put in place solutions that not only meet the compliance needs of today but also support the agility requirements of tomorrow.

SMITH: It's almost like there are two supply chains: the forward supply chain and the reverse or returns process. Brand owners must determine what to do with their previously shipped products as well as their newer, greener products. Do they want to manage the recycling themselves? Farm it out to a third party or turn it into some kind of service offering? Unless they're going to do it all by themselves, they'll need to work with their new supply chain partners to make sure that everybody's ready for these new shared processes. And then there are the longer-term, broader ramifications. Companies are beginning to think about, for example, whether to redesign products to reduce recycling costs.

"Companies are beginning to think about whether to redesign products to reduce recycling costs." —Chris Smith, RiverOne

What does it actually cost co panies to become compliant?

KAROFSKY: We estimate that it's 2% 4% of gross revenue for the first year compliance. We recently spoke with a billion consumer electronics compan that is spending about $30 million to comply. That will slow down to under 1 after next year. But that's forever.

Are any of the companies th you're talking with deriving any additional value from green compliance?

HOMAN: Some companies are. Again innovation leads the value curve in t industry. Those looking for value see as an opportunity to create that valu And it shows up in their differentiatio in the market, the way they sell, and how they position products. It also ha direct impact in terms of their citizen and their environmental stewardship

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New legislation "will require an even deeper integration into your core execution systems...."

—Ray Homan, SAP

So there are values that are both tangible on the revenue and sales side as well as intangibles in terms of corporate culture.

How can companies move forward with compliance?

HOMAN: This is just the beginning. RoHS compliance is due by July 1, and we have oncoming legislation from several Asian countries requiring compliance in the same timeframe. More complex European compliance legislation has already been announced. It will require an even deeper integration into your core execution systems and those of your suppliers. It's an industry challenge and a supply challenge, so it lends itself well to the cooperation of all parties to address these issues.

SMITH: Figure out how to minimize long-term costs by making products easier to recycle today. Companies need to consider their recycling options in each country. And they need to start going through a triage process of deciding which products go back to whom and where. Last, get started! These deadlines are going to come up very quickly. If you get caught flat, there's going to be a big price to pay.

BOUCHER: Early adopters are going to enjoy competitive advantage. If you can get your plans in place, assess your inventory, and ensure that you have strong ties to your operations, you can achieve a competitive advantage and mitigate some of your costs.

KAROFSKY: Remember, this is a market-disrupting event that will change the way business is conducted. There is opportunity as well as risk. Some people will find ways to make money and some will lose money. The whole challenge is figuring out how you can be one of the ones making money.

For a complete version of the roundtable go to http://www.RiverOne.com/roundtable

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Enter "reverse logistics." These capabilities help companies automate and streamline their returns process—providing customers with Web-based protocols for submitting returns and scheduling pickup of the goods, as well as business rules that determine the most efficient, cost-effective place to ship the returns so they can be repaired, refurbished, or scrapped.

Companies are clearly recognizing the value of reverse logistics. BAX Global, which offers such a service, has seen its use skyrocket, growing more than 30% in the last 30 months. Brand owners can analyze the data collected about customer returns. "Most enterprises seek control over the reverse logistics process," says Griffith. "With this service, they can track serial numbers, assess quality issues, and use the information to plan future manufacturing."

Having this information available helps companies centralize their decision making and reduce unnecessary labor costs. "Not automating reverse-logistics practices guarantees that you will be adding cost to your supply-chain processes by requiring human intervention to handle returns," says Griffith.

Columbus is a Role Model

The challenges of globalization are not insurmountable. Ansell Healthcare is finding that a combination of new supply-chain software from Infor, refined business processes, and commitment to cultural change is the key to smooth sailing in a flatter world. "We've seen obvious improvements in our forecast accuracy, especially in Europe," says Ralph Johnson, the Ansell executive. "Our customer-service levels are rising because products are actually available to meet demand. Over time, we expect to shrink inventories in the distribution centers by $50 million and cut lead times from 60 days to as few as 30."

Yet these improvements are neither automatic nor immediate. Managing the supply chain in this new world requires perseverance. "We are constantly working through the cultural issues, the data challenges," Johnson says. "It's not something you can do overnight. But the rewards are coming, and we won't stop until we reap them all."

About AMR Research

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COMPLIANCE

Say "Cheese"

Another industry force shaping supply chain management strategies is the need to comply with government and industry regulations and changing customer requirements. Berner Food Inc., in Dakota, Ill., is the dairy industry leading private-label manufacturer of processed cheese, sauces, spreads, and toppings. If processed cheese doesn't evoke images of precise supply chain operations, think again: Berner needs to meet evolving regulatory requirements for food safety and quality, including regulations such as the Bioterrorism Act of 2002.

Using supply-chain technology from Atlanta-based Ross Systems Inc., Berner created a system of record that supports cradle-to-grave knowledge of product manufacturing, distribution, and delivery. With the system, Berner can conduct mock product recalls, track products back to ingredient-level inventories, and determine within 30 minutes where a product from a specific batch is in the distribution cycle—even in most cases the shift and operator that produced it from Berner's suppliers.

"It's a different world today," says Gary Gold, vice president of quality assurance at Berner. "But if you make a map for success, you can get into a routine that supports compliance, product safety, and customer satisfaction. Our supply-chain strategy is to exceed our customer requirements, surpass the regulatory requirements, and stay ahead of the industry. By doing that, we don't have to look back."

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Carefully Clearing Yahoo's Clutter

A design whiz aims to enhance the home page—without fixing what ain't broke

LARRY TESLER HAS MADE A career out of making computers easier to use—the man invented the idea of cutting and pasting when he was an engineer at the legendary Xerox PARC research facility in Silicon Valley in the mid-1970s. But these days the 60-year-old whiz is facing a distinctly different design challenge. As the new vice-president of the user experience and design group at Yahoo! Inc., he's charged with fine-tuning some of the Internet's primest real estate: the Yahoo.com home page.

On one hand it's a rare opportunity to shape the design of a seminal Web portal that draws millions of visitors in a single day. "Anything I do will have a huge impact on a lot of people," he says. On the other hand, by many important metrics, what he's fixing ain't broke. While the page's current design won't win any beauty contests and lacks the simple elegance of archrival Google Inc.'s welcome mat, it works. And those millions of daily visitors might chafe at any overhaul that displaces Yahoo's myriad features. If Tesler were to scare off just 2% of Yahoo's daily users, it would amount to 3 million fewer visitors.

That's why no one is recommending a dramatic overnight overhaul. But design gurus and former Yahoo insiders interviewed by *BusinessWeek* all say the same thing: Yahoo.com remains cluttered and scattershot, almost schizophrenic. If looking at a company's home page is like reading its palm, Yahoo's tells the story of a company trying to be everything to everyone. There are headlines, celebrity gossip, e-mail logins, search—even Web hosting for small businesses. Is it a media company, a services company, or a search company? Says John Zapolski, a former manager of several design teams at Yahoo: "You can't immediately tell why Yahoo is the best at anything."

It's not just a matter of looks, either. Companies are increasingly embracing the idea that design is a key element of strategy, particularly for a Web com such as Yahoo, where user experien paramount. True, Yahoo—which bas ly pioneered the concept of the por has been on a tear, capturing the N spot in the *BusinessWeek* 50 list of top porate performers. But it faces hu well-heeled rivals such as Google, M soft, and America Online—all of w have made design an integral part of strategies for catching up.

In fact, Zapolski and other fo Yahoo employees describe the home as the single most contested issue wi the company. Yahoo researchers endl ly try to divine which are the most-u services. Meanwhile, business-unit doms within the company fight for po tially lucrative spots on page, ex-insiders say. The sult: While Yahoo has some innovative br throughs on "inside" pag such as its new music pl and interactive local map maps.yahoo.com—the f page has remained stagn Says Tony Hahn, former director of u experience at Yahoo who left to join s ware startup Rearden Commerce Inc April: "[The page] suffers from too m cooks in the kitchen."

THE BUSINESSWEEK 50 The Best Performers

Tesler downplays such internal jocl ing for position, but even to outside sign experts it shows. The page reads a hodgepodge of agendas, they say, wh finance is given the same hierarchical portance as horoscopes. It lacks fo and, surprisingly for a company na Yahoo, it lacks personality. It's "a p that wants to be so many things tha the end, it ends up being nothing," s Jesse James Garrett, director of user ex rience strategy at design firm Adap Path in San Francisco.

RIVAL MAKEOVERS

YAHOO'S COMPETITION is striving avoid this problem. Google.com is sentially a logo and a search box, s rounded by lots of soothing white sp The message is clear: Google is about search. AOL has recently designed its home page to emphasize company's exclusive video content. E Microsoft's MSN home pag no beauty, either—is lookin bit more streamlined th days. It launched a redesign l February, with 25% fe links, says Lisa Gu group products m ager for M "Based on

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feedback, it was absolutely the right decision," she says. MSN is testing even more radical changes with a spartan news site dubbed simply Start.com, which was put up several months ago with little fanfare. Tech enthusiasts appear to like it, Gurry says. It's such a clean, streamlined version of MSN's page that Netizens don't even have to scroll down to see the whole thing.

For the moment, Tesler is tight-lipped about what's in store for Yahoo.com, but he does offer some hints. "One thing I've been pushing hard since I got here is that using Yahoo should be a delightful experience," he says. Expect him to take advantage of more advanced Web browse and he may reduce clutter by "hidin material so users can opt to see mo news, for instance, by rolling their mi over a topic. That would be a big ir provement. But he has a long way to before Yahoo is a delight. ■

–By Sarah Lacy in San Mateo, Ca

What the Pros Think Yahoo! Should Do

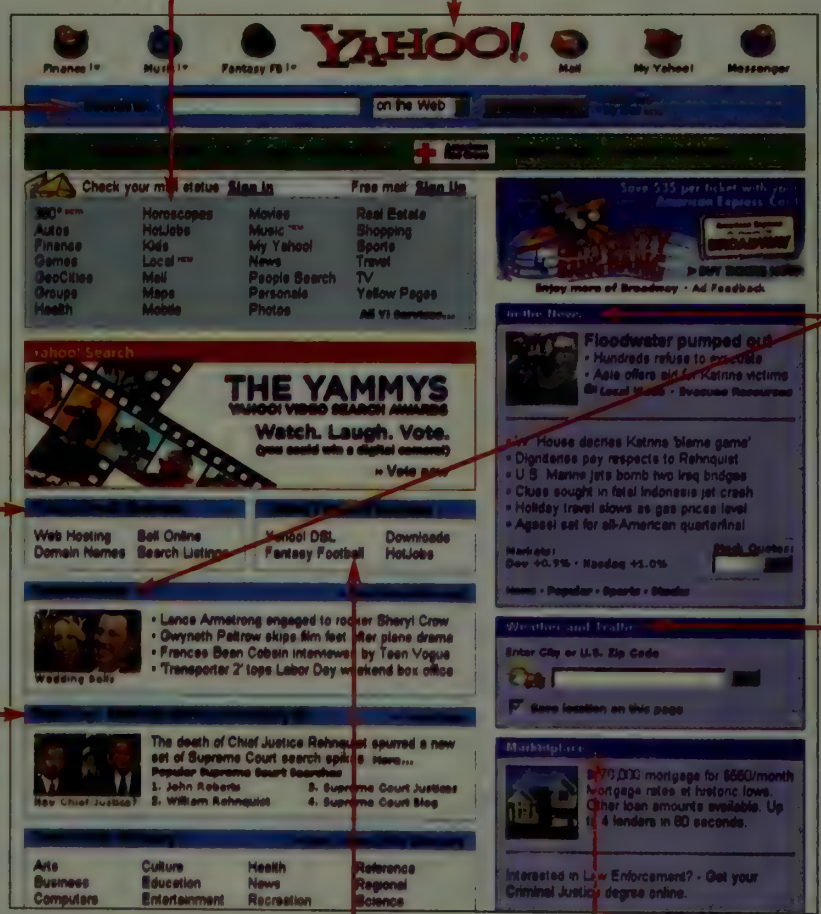
Some constructive criticism from the best Web design gurus:

1 SEARCH: Give Yahoo credit for making this one of the few clear priorities on the site. Over time it has moved to the top of the page and is effectively highlighted by a blue background. There are easy-to-navigate search category buttons at the top, and searching the general Web is wisely the default tab. Like other sites, advanced search is off to the right. It's a familiar, clear search bar, even if it is a bit cramped by the logo above and list of services below.

2 DESIGNERS find this unnamed box confusing. There's no apparent logic or order to what services appear here vs. other vaguely named boxes such as "Featured Services" and "More Yahoo! Services." In fact, some links, such as "HotJobs" and "Health," are repeated in other boxes.

3 LOGO: Experts disagree on the effectiveness of the cutesy Yahoo! logo and cartoonish buttons on each side. Most give these features credit for being one of the rare sparks of personality on the page. But Jeanine Guido, a barnesandnoble.com creative director, says the icons look like a high schooler designed them.

4 NEWS AND ENTERTAINMENT: Nice use of photos in these important sections. Instea of squeezing down a big photo, Yahoo smartly crop them to work with the sma format. Headlines are clea and well-written. But some experts complain about th News and Entertainment sections. Several pros suggest saving space by combining the two into one "What's New" box or at least signaling that they are both editorial content by making the boxes the same unique color. Designer Jakob Nielsen of Nielsen Norman Group gives Yahoo kudos for being one of the first sites to put only Dow percentage gains on the home page—not the raw numbers.



5 WEATHER: The one part of Yahoo's home page that everyone loves. Once you enter any information indicating where you are, the Weather Box automatically shows the weather in your city. The more such automatic customization Yahoo can offer, the better, experts say In fact, this box is so popula that it should be moved up much higher.

9 SMALL BUSINESS: It has a high placement, but it's totally out of step with the rest of the consumer-aimed page. Experts recommend that Yahoo take the radical step of axing it altogether. If small businesses are coming to Yahoo for Web hosting, they'll find it through another box.

8 BUZZ LOG: The text isn't always as clear here as in the News and Entertainment section, but it's a rare spot of user interaction on the site. "Great traffic-building module," says Thomas Mueller, a designer at StudioTM. "Users love to see what other users search for." Combined with the Entertainment box, it makes Yahoo look hip. The site should focus more on that kind of media content and less on hawking its services.

7 THIS IS A NEBULOUS BOX: The grouping of links makes little sense. What do Fantasy Football, DSL Service, and HotJobs have in common? Talk about confusing. And why are these links higher up than, say, classifieds? Yahoo tries too hard to drive traffic to its own services.

6 THE MARKETPLACE BOX gets as many boos as the Weather Box gets cheers. From a design standpoint, it looks the same as Yahoo's editorial content, but it's essentially a series of ads. "It's the worst area of the site," says Nielsen.

BusinessWeek online For an expanded critique of Yahoo's home page and a Q&A with Larry Tesler, Yahoo's vice-president of user experience and design, go to businessweek.com/extras

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BENIOFF He sees his latest initiative as the next step in on-demand computing

An eBay for Business Software

Salesforce.com CEO Benioff is betting his new idea will land him in the big time

ON FIRST GLANCE, Marc Benioff doesn't seem like a man in a hurry. The bearlike 40-year-old chief executive of software pioneer Salesforce.com Inc. favors Hawaiian shirts and rarely shows up in the office before noon. He eases into the day with yoga workouts and barefoot walks on the beach. Yet, since he cofounded San Francisco-based Salesforce.com six years ago, he has been dreaming up big ideas at a dizzying clip.

The most recent one came in June. That's when Benioff introduced a technology, named Multiforce, that he calls an operating system for the Internet. Customers and software makers can create applications for Multiforce that can be used over the Web like Salesforce's own software. In essence, he turned Salesforce.com into a platform for others to build upon—much like Microsoft Corp.'s Windows.

Now, Benioff is planning an even more sweeping initiative. On Sept. 12, he's scheduled to unveil something called AppExchange, which he envisions as nothing less than the eBay of corporate software. It's an online marketplace where software makers and custom can swap and sell applications they c velop. Companies interested in new so ware capabilities can search through menu of applications. When they fi something they're interested in, they c read reviews by others, try it out for fr and buy it with a few clicks.

Salesforce.com's products fall into broad category of software called cu tomer relationship management, or CR in industry-speak. They help compani manage all sorts of customer relatio such as letting salespeople keep track leads or helping execs judge the succe of marketing campaigns. The applic tions on AppExchange, however, can any kind of business software. And ju like Salesforce's products, they'll be a cessible to any subscriber with a W browser and Internet access.

Benioff contends that this approa will eventually change the entire stru ture of his industry. Software over t Web—commonly called on-demand—a counted for less than 10% of the $46 b lion in corporate software sold last ye But he says creating an open marketpla for on-demand software will help cau the decline of the big, complex, and e pensive corporate applications sold by t likes of SAP and Oracle Corp. "It's a b

ap for us," Benioff says. "We think it ill show the world the next step for on-emand computing, just as we showed e world the first step."

Salesforce.com is under pressure to take e next step because the market it pio-eered is getting mighty crowded. Siebel c., the longtime leader in selling tradi-onal CRM software packages, sells an on-emand version, as do a handful of start-ps. Microsoft, which offers customers its RM software online, is about to issue a ajor upgrade. Most worrisome, giant AP is expected to offer an on-demand ver-on by yearend. They're all vying for eces of a broad on-demand software arket expected to grow to $10.7 billion in 09, from $4.2 billion last year, according researcher IDC.

OYALTY GAMBIT

PPEXCHANGE strengthens Benioff's nd. The marketplace makes it possible r the company to offer a large array of ftware that it could never afford to build itself. At the same time, if customers dopt other applications running on its mputers, they will be less likely to leave for a competitor. While Salesforce.com on't receive any fees when companies y applications on AppExchange, it ex-cts the marketplace to help expand its stomer roster and revenues.

The risk for Benioff is that he might be ying to do too much, too fast. Can he eep all of these balls in the air at once? ossibly, but it will be a lot harder than vimming with dolphins—one of his obbies. While more than 80% of Sales-rce.com's customers are small and edium-size businesses, the company as recently been trying hard to attract rger enterprises lately. It's not clear if alesforce will be able to serve both mas-rs. At the same time, to seed AppEx-hange, the company is writing more than two dozen applications itself, potentially putting a strain on its staff. "They're trying to be both an applications company and a platform company," says analyst Rebecca Wettemann of researcher Nucleus Research Inc. "It's a lot for a small company to do."

Salesforce.com is showing signs of strain. The company delivered strong quarterly results on Aug. 17, reporting revenues up 77%, to $71.9 million, and net income up 331%, to $5 million. It landed a handful of major contracts, including a 5,000-person deal with Merrill Lynch & Co. Still, the company forecast revenues of $78 million to $80 million for the next quarter, while analysts had been looking for as much as $84 million. Its stock slid 8.5% the next day, to $20.32.

Salesforce's aim to serve both large and small clients may pose a risk

AppExchange could help spark a rebound. Benioff did not pre-brief Wall Street on his plans, but industry analysts who got briefings are intrigued. "I think a lot of small software companies will sign up. They'll want to be on the magic bus with Marc," says Bruce M. Richardson of market researcher AMR Research.

Benioff had software's small-fry in mind when he dreamed up AppExchange. He saw that Multiforce would make it possible for software developers to market their programs to all comers via a vast directory. Already, 35 software makers have 70 applications under construction. Among the software makers: Intacct Corp. of San Jose, Calif., which plans on making its entire suite of on-demand accounting and planning software available via the marketplace.

But the appeal of AppExchange isn't limited to the tech industry's pint-sized players. Consulting giant Accenture Ltd., which just started building a systems integration practice around Salesforce's offerings, is considering writing programs to run on AppExchange. "I was a skeptic two years ago that Salesforce.com would make its way in the enterprise, but we're now seeing our customers deploy it," says Woodruff Driggs, head of Accenture's CRM system-integration business.

Merrill Lynch, for one, is avidly interested in Benioff's marketplace. It's thinking about asking some of its own tech suppliers to sign up for AppExchange. That way, their applications will run more dependably and will be better integrated with other programs running on the Multiforce platform, says Andy Brown, Merrill Lynch's chief technology architect.

For Salesforce.com's smaller customers, AppExchange holds some of the attraction of Linux and other open-source software. Once they write a Salesforce.com add-on for their own use, they can simply press a button to make it available to others—with their data removed. Amit Saxena, customer management leader for credit report distributor First American CREDCO in Poway, Calif., expects to buy, sell, and share applications.

Benioff's competitors make light of his grand vision. "It looks great on PowerPoint, but on planet Earth, it won't fly," predicts Zachary A. Nelson, CEO of NetSuite Inc., a small software-on-demand specialist. Nelson and other rivals claim that Salesforce.com's own applications don't meld well with traditional corporate software. Shai Agassi, a member of SAP's executive board, says there's no way an aggregation of small applications like AppExchange could replace SAP's packages, which he says provide about 80% of what's needed to run a company. "Salesforce.com is a CRM company. Marc is trying to make noise and buzz about something bigger, but that's all it is," he says.

Analysts agree that AppExchange won't replace SAP's armada of programs—at least, not anytime soon. But they see it as a smart idea that would play very well in small and medium-size businesses. "I think this ecosystem will grow, and it will grow fast," says analyst Robert P. Desisto of market researcher Gartner Inc. If that happens, and Salesforce.com's momentum keeps up, you can expect Benioff to keep firing off his big ideas. ■

–By Steve Hamm in New York

An Online Applications **Mart**

Salesforce.com started out selling software for salespeople, delivered via the Internet. Now, with the new AppExchange, it's attempting to become a marketplace for a wide variety of corporate applications.

CUSTOMER CONTRIBUTIONS After they create customized programs to run on top of Salesforce.com, customers can post them on AppExchange, either to sell or share. For example, a company that develops a program for calculating its salespeople's compensation could sell that program.

SOFTWARE SALES Software makers can create versions designed to run on top of Salesforce.com's service and post them for sale on AppExchange.

SALESFORCE'S STAKE The company won't take a cut of each sale the way eBay does. Still, it expects the marketplace to boost demand for its own software.

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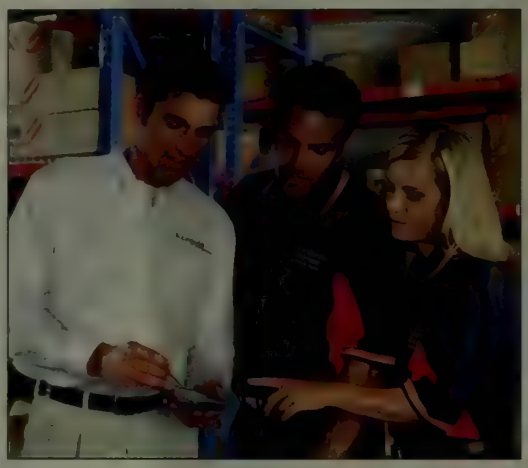

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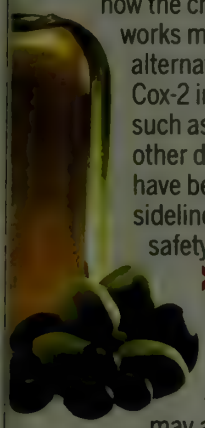
EDITED BY
ADAM ASTON

INNOVATIONS

Of olive oil and rare diseases

>> A team of scientists led by the Monell Chemical Senses Center in Philadelphia has discovered a natural chemical in virgin olive oil that reduces inflammation. The substance—named oleocanthal and described in the Sept. 1 issue of the journal *Nature*—inhibits the pain-causing Cox-1 and Cox-2 enzymes. Further research into how the chemical works might yield alternatives to Cox-2 inhibitors such as Vioxx and other drugs that have been sidelined by safety issues.



>> A drug being tested to treat cancer may also help fight a rare genetic disorder that causes premature aging. The disease, called progeria, strikes one in 4 million babies, prompting their cells to age so rapidly that patients rarely live past the age of 12. There are no treatments. On Aug. 19 scientists from the National Institutes of Health announced that a class of experimental drugs called farnesyltransferase inhibitors (FTIs) not only block some cancer-causing proteins but also reverse aging in skin cells taken from progeria patients. If the researchers can validate their discovery in mice, they may launch human studies in 2006.

–Arlene Weintraub

HEALTH

SKIN-CARE SECRETS OF THE HIPPOPOTAMUS

A 49-YEAR-OLD hippopotamus named Bulgy may hold the key to the next generation of sunscreens. Christopher Viney, a professor at the new University of California at Merced, has spent the past year collecting and scrutinizing sweat from the 6,500-pound mammal, which lives at the Chaffee Zoo in Fresno, Calif. Viney hopes that as Bulgy perspires, he'll also inspire new ideas in the fight against cancer-causing ultraviolet rays.

Hippo sweat, it turns out, is a marvel of skin protection. In addition to preventing sunburn, the red gelatin-like ooze seems to ward off insects. And even though hippos sustain scrapes and bruises as they aggressively defend their territories, the wounds rarely get infected—suggesting their sweat might also be a powerful antibiotic.

Viney is preparing a paper describing the molecular structure of hippo sweat. Bulgy is waiting for his next skin-care consulting gig.

–Arlene Weintraub

MATERIALS

A PLASTIC RADIATION SHIELD FOR SPACESHIPS

IT MIGHT BE THE LATEST example of thinking outside the box, or bag in this case—specifically trash bags. They are made from polyethylene, a plastic that is cheap, tough, and keeps bad smells inside. But NASA is flipping that around: The same material might keep radiation outside a spaceship.

Because trash-bag film is too flimsy for a spaceship, NASA researchers Raj Kaul and Nasser Barghouty began adding "secret spices" to polyethylene. The best result so far is called RFX1. The material is not only stiff but also three times stronger than aluminum—and 2.6 times lighter. More important to astronauts on future missions to Mars and other long space flights, the material might reduce the risk of developing cancer because it blocks solar radiation and cosmic rays better than aluminum.

RFX1 is just for starters. Among other shortcomings, it may not hold up under prolonged exposure to the searing, 450F heat of the sun in space. So look for an RFX2.

–Otis Port

POWER

GENERATING JUICE FROM A BACKPACK

A NEW BREED OF backpack can convert the motion of walking into electric power. Designed to help soldiers and emergency responders keep their radios going longer and ease their load at the same time, the suspended load backpack (SLB) has a rigid frame, like those on hiking packs. But the bag itself is fastened to springs and slides along a track. As you walk, the load rises and falls a few inches, driving an assemblage of gears connected to a generator (for a video, go to businessweek.com/extras).

The power output increases with the weight of the pack and the speed of the walker, says Larry Rome, a

biologist at the University of Pennsylvania who led the SLB's development. When worn by a walker moving at a steady clip, carrying 40 to 80 lbs., the pack puts out up to 7.4 watts—plenty to power a head lamp, phone, and global positioning system device. The spring-based design also reduces the peak effort needed to carry a given load. With patents pending, Rome plans to start licensing the design by next year.

Virtual Dieting

NutriSystem is hot again thanks to new management and a revamped business model

LESS REAL ESTATE Now the company ships a month's worth of shelf-stable food to customers.

VIRTUAL ADVISER Counselors work with customers by phone and online instead of in person.

MARKET DIRECT Direct-response print and TV ads drive weight-loss wannabes to the Web site. Extended pitches on home shopping channel QVC drive 11% of sales.

How NutriSystem Got Fat and Happy

A Web-centric approach, real-people ads, and less real estate have profits taking off

SHEILA DUREN IS ABOUT to make her television debut. After losing 72 pounds in six months on food she purchased from NutriSystem Inc., the 37-year-old Dallas resident responded to a company-sponsored contest and became one of NutriSystem's newest models. In a series of TV ads that began airing this month, Duren is seen catching a bouquet at a mock wedding—wearing nothing but a bikini and high heels. "It's been a long time since that many people have seen me in that little clothing," Duren says.

It's been a while since NutriSystem felt that sexy, too. The veteran diet-industry player was bankrupt a decade ago, then reinvented itself as an Internet distributor in 1999, struggling to sell its prepackaged meals through banner ads on Web sites. It took Net entrepreneur Michael J. Hagan to turn things around, ironically by shifting NutriSystem's ad budget from the Web to traditional medi

That's right: In an era when the ma ket value of Google outstrips that of Ga nett, Washington Post Co., and New Yo Times Co. combined, traditional med are still a powerful marketing tool. Th year over 80% of NutriSystem's $35 mi lion advertising budget will be spent c TV, radio, and print, even as an equal-si portion of its food orders comes in ov the Web. "The Internet can make you low-cost distributor," says Hagan. "But create the urgency to order now, you nee the imagery of TV and print."

The results have been as dramatic a Sheila Duren's weight loss. This yea NutriSystem sales are expected to h $150 million, up from just $27 million i 2002 and passing Wall Street expecta tions from early in the year by 75%. Th company should generate about $14 mil lion in net profit this year. While man weight-loss players are feeding on th public's growing awareness of the peril of obesity, few are expanding as quickl as NutriSystem. Shares in the Horshan (Pa.) business have risen from $1.39 t almost $23 in the past year, makin it one of the best-performing stock on the NASDAQ.

REPS' ROLE

HAGAN, 42, IS AN unlikely evangelist fo traditional media. He co-founded VerticalNet Inc., an operator of e-commerce sites for industries such as steel anc wastewater treatment, in 1995. VerticalNet was briefly worth $11 billion in the late 1990s before falling to its current value of $30 million. "Volume didn't take off," he says, "because distributors and manufacturers' sales reps play such an

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important role [in corporate purchases]."

Founded as a diet centered on low-calorie protein drinks in 1972, NutriSystem once had 1,500 weight-loss centers in the U.S. before competition and overexpansion forced it into bankruptcy. Taken over by Chicago-based financier Michael E. Heisley, it began closing centers and shifting to a Web-based model—but with limited success. Hagan heard Heisley was looking to get out and swooped in with an investor group that bought a 58% stake for $10 million in 2002.

Hagan focused on quality and convenience. Jay Satz, one of NutriSystem's original dietitians, was hired to revamp the menu. And instead of slogging to one of 1,200 strip-mall locations for a weigh-in and to buy the food, customers for $279 per month get the food delivered to their door and track progress online. It's the convenience customers respond to, says Hagan. "It's just an easy, breezy program!" coos one satisfied client in a new print ad.

NutriSystem has tapped into the mindset of the constant dieter. Not many want to spend time in group therapy or even be counseled one-on-one. Counselors are available by phone or online chat, but less than 20% of clients use them. Most seek support on the message boards of the company's Web site. Dieters on portion-control plans like NutriSystem's lose 5% of body weight after one year if they stick to it, according to many studies.

But of course, most don't. The average customer stays on the program just 10 weeks and loses about 2 pounds per week. About one-third come back within a year, many having regained the weight. "It's a sad thing from the consumer's standpoint," Hagan says candidly. "But it makes a very attractive business model."

Unlike competitors, Hagan steers clear of celebrity endorsers. Weight Watchers International features Duchess of York Sarah Ferguson, and Jenny Craig recently embraced *Fat Actress* star Kirstie Alley. NutriSystem's ads feature actual customers, such as Duren, who have shed pounds. "Celebrities are risky," Hagan says. "If they don't lose the weight [or relapse] it can work against you."

Hagan eats NutriSystem food at the office, but he's no zealot. He bought NutriSystem because he saw a [illegible] but underutilized brand. Hagan's not completely against brick-and-m[illegible] either. He recently purchased the [illegible]-unit Slim & Tone fitness-center franchise and plans to expand it in part as a way to cross-sell the NutriSystem plan. After all, you can't run on a treadmill online. ■

–By Christopher Palmeri in Los Angeles

DIETING

My Dinner With NutriSystem

It may be a bit cynical for CEO Michael Hagan to point out that the failure rate of dieters is what makes NutriSystem a good business. But it's also true. An estimated 55 million Americans will go on diets this year. And while some will succeed in losing weight, very few—perhaps 5%—will manage to keep it off in the long run. Close to $40 billion will be spent on diet foods and programs this year, not including the cost of weight-loss surgery.

NutriSystem's program and others like it that give customers prepackaged, preportioned food may not be for everyone. But such regimes confront perhaps the worst habit of weight-gaining Americans: eating helpings more appropriate to members of Lewis & Clark's expedition than to sedentary office workers. "Americans, aided by the restaurant industry, have lost all sense of what normal portioning is," says Jay Satz, the company's chief nutritionist. Thomas Simon, a thin 20-year-old French student visiting the U.S. for the first time last August, for example, ordered a ham sandwich, and was astounded by nearly one pound of filling. In France, a ham sandwich has one layer of ham on a baguette with light butter. "Too much. Too much," he said of the U.S. version, holding his belly.

Satz admits that not every NutriSystem dish is delectable. But the lasagna, pasta fagioli, and macaroni and cheese with beef in a cup reflect what people "eat in real life." The meals and snacks, all packaged to keep without refrigeration, are not unlike offerings from competitors and have a mushy nursing-home quality when heated. Neither Simon nor any other Seine-strolling Frenchman would stomach the beef Burgundy with rice. And the Thai noodles with peanut sauce and tofu, left on my desk for two days, sent a vegetarian colleague fleeing.

PORTION MANAGEMENT A NutriSystem pasta entrée

But the food is not aimed at subscribers to *Cook's Illustrated*. A lot of people gain weight because they eat food of little nutritional value on the run. "Convenience and ease of preparation is as big an issue for us as any big food company," says Satz. Clients are strongly urged, Satz adds, to "fiddle" with their meals by adding their own herbs and spices.

Even if one man's NutriSystem basil chicken with tomato sauce is another man's Reebok in red gravy, a study by *Consumer Reports* earlier this year nevertheless concluded that controlled-portion diet plans like NutriSystem's were most effective. One study of 302 overweight volunteers conducted at five medical centers, cited by *Consumer Reports*, found that the group eating prepared meals lost three times as much weight in a year as the group on a diet in which portions were not controlled.

Most dietitians say people would be better off using fresh food of their own served in small portions. Experts agree, though, that the most effective diets are ones people can stick to "based on their food preferences, lifestyle, and medical profile," says Dr. Michael Dansinger, director of Tufts-New England Medical Center's Atherosclerosis Research Laboratory. Meanwhile, here's a quick tip to get started on portion control: Get rid of the big dinner plates and eat meals on salad plates or even saucers.

–By David Kiley in New York

ADVERTISEMENT

Even the most sophisticated monitoring systems are only as adept as those who are managing them."

– Ira A. Lipman
New York

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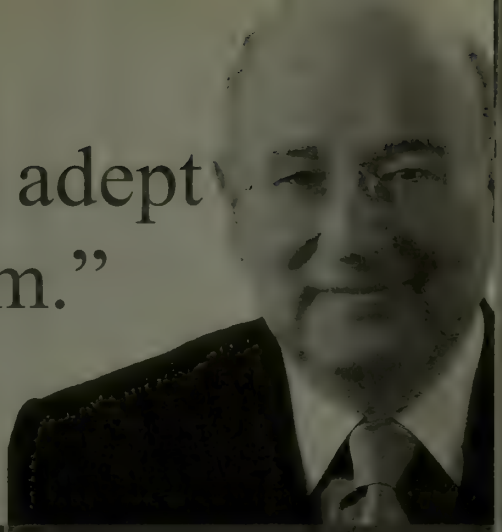

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Investments in sophisticated technology e augmented by the selection of people an respond to security threats quickly and ively. Society looks to the security industry otection, and we have a responsibility to te the public about the necessity for nt vigilance. At the same time, the ty industry faces an opportunity to grow elevate the reputation of the profession.

- Ira A. Lipman
Founder and Chairman

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Being serious about security is not just employing more security officers or g more technological equipment. It is about aching security in a different, smarter way. bout knowing the backgrounds of one's yees and on-site contractors. It is about ing that the one person accountable for ity also purchases security. It is about dering the realm of possible threats and oping proactive solutions. It is about ng vendor partnerships to give others a in ensuring that all that can be done is It is about a commitment to total quality.

Do you compromise on security when it s to protecting your family? Experts know ***he more you do, the safer you are.*** place security is no different; only the s are much greater. A large corporation is n extended family living in a huge borhood: the chance of something going g somewhere increases with scale and there ore lives and livelihoods at risk.

Not all organizations think about security in terms of its total cost—at their peril. Some corporate budgets measure the dollars spent on security personnel and equipment but ignore the costs of crime and terror—the human tragedy, the liability expenses, the legal fees, the public relations and crisis management costs, the increased insurance premiums, the lost revenue from business interruption, the shaken confidence of customers and shareholders, the devastation in employee morale. Consider one example: A terminated employee, heavily armed, gains unauthorized entry past a new and inexperienced security officer. A single mistake, and several minutes later, lives are lost. Just one such tragic incident can jeopardize the future survival of an entire organization.

When companies view security services as a commodity, that is what they get. Some purchasing departments often only look at the unit cost, selecting the lowest bidder. Many service providers, however, fail to include additional costs, such as health insurance, vacations and even training, in their rates—which the customer may not discover until the invoicing starts. Other companies compete by minimizing their investment in wages, training and employee screening. Transient hourly employees treat their jobs in a perfunctory way. With limited authority, security managers cannot invest in quality or innovation. And yet if a serious incident occurs, they take the blame for failing to bring in a quality provider. This vicious circle detracts from buying the necessary value and focusing on what truly counts in security—results.

No entity can be entirely immune from crime and terrorism. When organizations commit time and resources to an urgent focus on security, however, they can minimize risk and create tangible value. A thoughtful security infrastructure supported by dedicated, energetic employees offers a shield against attack and often surpasses the traditional call of duty: responding to an accident on the shop floor and saving an employee's life or detecting a mechanical malfunction that could lead to a plant shutdown. A strong security program also acts as a deterrent. According to reports published in a leading national newspaper, a murderous terrorist cased a sensitive public facility in California and found the Guardsmark security to be so tight that he selected different targets, shooting six people and killing one. The wounded included three children.

Whatever concerns our clients face—from routine loss prevention investigations to dealing with kidnappings and assassinations in distant lands—our men and women stand ready with the wisdom of experience, the ability to manage uncertainty, and an intricate network of valuable relationships. These crisis-resolution skills give our clients the confidence that their security provider can respond to any emergency anywhere at a moment's notice.

Increasing emergency preparedness is essential to minimizing casualties. The ability of the United States to strike back with swift, devastating force does not deter agents of terror. Consequently, local governments must receive assistance to prepare for attack and to improve the technological capabilities of our emergency response agencies. Similarly, every organization must not only strengthen its defenses to prevent an attack, but it must also prepare to manage the aftermath of a successful assault by training on-site emergency responders and developing partnerships with firefighters, police and medical professionals. Securing a facility so that an attack will either fail outright or produce minimally disruptive consequences at best will significantly decrease the likelihood of a future strike.

The world has changed. Complacency has never been wise, but at this time of increasing uncertainty, it has become outright dangerous and irresponsible. At Guardsmark, we realize that each of our employees is the critical ingredient in securing some facility somewhere. Who that person is, what that person thinks and how that person reacts may make the difference between calm and calamity. That is why we are committed to excellence in management, to continuous innovation, to organizational ethics and diversity, and to an unyielding focus on the customer. It all has to do with being serious about security. That is our mission. And we believe that is the mission that you need. ***The time for urgency is now***[SM].

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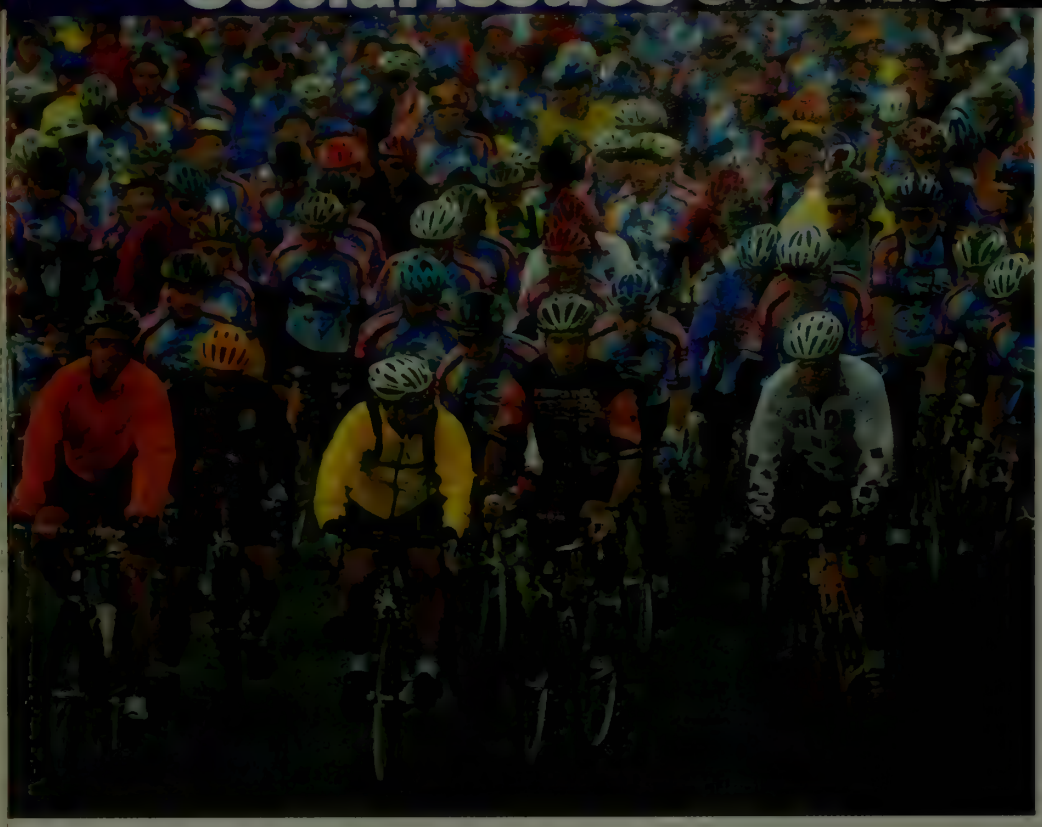

Sweating For Dollars

Bikeathons and other athletic events are a runaway success for fund-raisers

TWENTY YEARS AGO, A surgeon in Tacoma, Wash., came up with the quixotic idea of running around a track for 24 hours to raise money for the fight against cancer. After collecting $27,000 in pledges, he realized he could multiply donations by forming teams to run a relay. From that humble start, the American Cancer Society's Relay For Life has mushroomed. More than 3 million Americans will run or walk in 4,400 relays this year, stretching from Miami to Eureka, Calif., and raise some $300 million.

Ever since that first run, health charities have been staging walkathons, bikeathons, and other -athons to raise money and promote awareness of everything from AIDS to leukemia. Their success has made such events the key fund-raising vehicles for many health-related causes. They account for about a third of the Cancer Society's $1 billion annual budget. More than half of the funding for the

$20 MILLION for cancer in the Pan-Massachusetts Challenge

Leukemia & Lyr phoma Society d pends on two high successful atho type events, whi has helped its budget explode to $2 million, vs. $35 million in 1995.

In all, walkathons and other ever raise $1 billion a year, experts say, dra ing in more than 10 million participan "But the real impact is far larger," sa Cancer Society Executive Vice-Preside Harry Johns. By mobilizing volunteer these events have raised awareness of di eases and helped persuade Congress double budgets for the National Canc Institute and National Institutes Health in recent years. With ever mo charities jumping on the bandwago there's now even concern that walkatho could get overexposed.

Much of the explosive growth in th movement has been stoked by the i volvement of large employers. Until th mid-1980s, most events were just a fe notches above the bake sale—commun ty-based events that typically raised le than $100,000. Then a consultant name Steven H. Biondolillo helped recru teams at companies for Boston's Proje Bread Walk for Hunger in 1985, rath than go door-to-door. It was the first on city event to raise $1 million in a day more than double what it had earned th year before, says Biondolillo, who Wellesley (Mass.) firm helps nonprofi plan walkathons.

Today, corporate teams play a centr role in most such events. This year March of Dimes' WalkAmerica expects million walkers in 1,100 venues to brin in $100 million. About 80% of the wall ers belong to one of 22,000 teams, mar of them organized by Kmart, Cign FedEx, and others. At FedEx, more tha 12,000 signed up for WalkAmerica th year, raising $1.6 million. The gains flo both ways, says Executive Vice-Presider Ken May, who runs FedEx Kinkos: "Th esprit de corps it builds is incredible."

Some companies go all out with spor sorships—such as Ford Motor Co., whic

Robust Business

Each year at least 10 million Americans take part in walkathons, bikeathons, and other health fund-raisers. Some of the most successful:

NAME	SPONSOR	PARTICIPANTS	MONEY RAISED
RELAY FOR LIFE	American Cancer Society	3 million	$300 million (2005)
HEART WALK	American Heart Assn.	1.5 million	$94 million (fiscal 2005)
TEAM IN TRAINING	Leukemia & Lymphoma Society	30,000	$97 million (2005)

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As national sponsor, Toyota invites you to lend a hand on Saturday, September 24th to support National Public Lands Day, a day when you can help spruce up your beautiful lands. Last year on this day, nearly 80,000 volunteers built trails and bridges, planted native trees and removed trash at 600 sites all across the nation.

To find out how you can help in your community, go to www.publiclandsday.org or call 800-VOL-TEER (800-865-8337)

HELPING HANDS FOR AMERICA'S LANDS

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National Public Lands Day

TOYOTA

for 11 years has backed the Susan G. Komen Breast Cancer Foundation's Race for the Cure, which draws 1.5 million participants to more than 100 five-kilometer races. Ford dealers and employees show up for every race. Since 2000, Ford also has sold designer scarves to raise money for Komen.

RUNAWAY GROWTH

THE EVENTS are largely divided into two classes: elite and populist. Elite ones require participants to complete tough physical challenges and meet high fund-raising goals—thus the few entrants. One of the best, the Pan-Massachusetts Challenge (PMC), requires cyclists to raise at least $3,000 to ride its two-day route from Sturbridge to Provincetown each August. Last year, just 3,800 riders raised $20 million for the PMC, which gives the money to the cancer-fighting Jimmy Fund, up from $9 million in 1999. The Team In Training (TNT) program run by the Leukemia Society requires participants to train for months for a marathon, triathlon, or other extreme challenge. In the year ending in June, 30,000 TNT volunteers raised $97 million.

Populist walkathons offer easier events and set few, if any, fund-raising minimums. The four biggest—Relay For Life, WalkAmerica, Race for the Cure, and the American Heart Assn.'s Heart Walk—draw at least 1 million walkers each. Such events educate as well as raise money. "Public attitudes toward breast cancer have changed dramatically since we started Race for the Cure" in the 1980s, says Susan Braun, CEO of the Komen Foundation. Victims who used to suffer in silence, now "can talk about it everywhere," she says.

Walkathons' runaway growth has some worrying about charity fatigue. Although AIDS Walk New York raised a record $5.8 million in May, AIDS walks in Boston and Chicago have shrunk drastically, and the Pittsburgh one was cancelled, says Craig R. Miller, president of MZA Events Inc., who started the AIDS walks. Overall, AIDS fund-raising is off 20%, he says. But the breast cancer movement is thriving, and newcomers keep jumping in. The American Lung Assn., which launched its Asthma Walk in 2001, drew 60,000 walkers last year and raised $8 million, up from $500,000 the first year. Clearly, it's an age when millions of Americans are willing to walk, run, or ride to combat disease. ■

–By William C. Symonds in Boston

OVER THERE The new FX series deals with the war in Iraq

FX Aims for HBO's Cachet

Higher-brow original programming is grabbing audiences and advertisers

IN 2002 THE HIT COP DRAMA *The Shield* won a Golden Globe, putting FX Networks on the map for the first time in its then-eight-year existence. The accolade was toasted heartily at the News Corp.-owned channel, which had often been dismissed as just another rerun outlet in the 400-channel TV universe. It was also a big step toward overcoming what everybody in TV was feeling at the time — HBO envy. Then CEO Peter Liguori believed FX could also create programming that pushed buttons and boundaries, the risky formula that had established Home Box Office as an Emmy Award-winning machine. A higher profile for FX would be increasingly critical in the years ahead, in any case, as it faced tough negotiations t stay on the basic cable roster. Advertiser Liguori promised his executive tean would get on board with these new shows

Trying to position FX as basic cable' answer to invincible HBO may soun brazen, but News Corp. founder Rupe Murdoch is no stranger to taking on en trenched TV players. Fox Sports, hi powerful collection of regional sport networks, has triggered more than a fe headaches at ESPN in recent years. Fo News, once a long-shot effort to unsea stalwart CNN, quickly captured the rat ings crown. So Murdoch didn't hesitat to embrace the idea of a channel whos shows could be water-cooler chatter "There was a huge push to create buzz,"

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says Derek Baine, a cable analyst at consultant Kagan Research.

Today, FX is home to some of the most original shows around. Following *The Shield*, FX won critical acclaim in 2003 for *Nip/Tuck*, a quirky drama about Miami plastic surgeons, and last year for the post-September 11 firefighter drama *Rescue Me*, starring Denis Leary. FX took its boldest step yet this summer with *Over There*, about U.S. soldiers in Iraq—the first time an ongoing war has been depicted in the U.S. on the small screen. Although fiction, its combat scenes are more graphic than most of the images found on the nightly news.

Aside from the gritty topicality of *Over There*, FX also has the advantage of revenues from distribution fees and advertising. Ad-free HBO, which has 28 million subscribers, relies on the extra $12 or so a month people are willing to pay to receive its shows. An HBO spokesman declined to comment on comparisons. FX, now in 89 million households, is drawing a younger audience. It ranks among the top five cable channels for share of the prime-time audience of 18- to 34-year-olds. That's great news for Murdoch, whose larger drive is to push News Corp. into younger markets. As part of his recent foray into Internet businesses, including the July purchase of Intermix Media Inc.'s MySpace.com, FX can play a strategic role via cross-promotions and advertising packages for his new Net businesses.

FX's advertising revenues tripled from 2000 to 2004

HILL STREET HONCHO

FOR FX'S GAMEPLAN to be successful though, it will need to establish itself, as HBO did starting in the 1990s, as a haven for creative writers and producers. Already, it's becoming a bigger draw. Actress Glenn Close joined the cast of *The Shield* last year. Morgan Spurlock, director of the anti-fast-food documentary *Super Size Me*, created and hosts the reality show *30 Days*, about people put in trying situations for a month. Last sprin Liguori was elevated to r Fox Entertainment. His su cessor, John Landgraf, a fo mer NBC programming exe utive, is keeping fresh sho coming and supporting the with big marketing ca paigns. "The things th branded HBO best were *T Sopranos* and *Sex and City*," he says. "Our decisi is to do the same thing [with our hits]."

It was Landgraf who envisioned a seri about the war in Iraq. He pitched the idea Liguori in late 2003, before he joined FX president of entertainment. TV has alwa dealt with current events, he says, "so seemed odd to me that nobody was willi to deal with this war." Landgraf reache out to his longtime idol, *NYPD Blue* an *Hill Street Blues* writer/director Steve Bochco, to be executive producer for *O There*. Landgraf, 47, is working with act George Clooney and director Steve Soderbergh on a series set in mode times based on the Ten Commandments

As FX focuses on the present, HBO seem to be looking backward as it struggles reassert itself after the end of *Sex and t City*. Its latest project is *Rome*, a $100 mi lion, 12-part series that begins in 52 B. That follows another period project, *Dea wood*, a Western set in 1877 that was crea ed by *NYPD Blue* veteran David Milch.

To maintain FX's momentum, Mu doch appears willing to keep its purs strings open. After enduring years of pu downs about Fox's lowbrow realit shows, Murdoch enjoys having well-re garded shows on his roster. It doesn hurt, either, that the numbers look goo FX's revenues nearly doubled from 200 to 2004, to $489 million, according t Kagan. And ad revenues alone tripled i that period, to $212 million.

Some of those revenue gains are bein eaten by higher programming costs as F broadens its slate, particularly in th search for comedies. So far that effor hasn't been a barrel of laughs. Two of thi summer's entries, *It's Always Sunny i Philadelphia*, about three friends wh own a bar, and *Starved*, focusing on me with eating disorders, bombed. Still Landgraf sees his channel as a maveric operation. "There's a scruffy, can-do atti tude," he says. "It's how I imagine th early days of Nike or Apple Computer."

Of course, Landgraf need look n further than his own corporate head quarters for can-do attitude. Just ask CN and ESPN. ■

–By Dana Goldstein in New Yor

NEW DRAMA Emmy winner Braugher stars in *Thief*

What's in the **Pipeline?**

News Corp.'s hot cable channel is hoping to build on its recent hits with these upcoming projects:

THIEF Stars Andre Braugher (*Homicide*) as a professional bank robber looking for one more big job before going straight. Set to debut in spring, 2006.

THE FAMILY PROJECT A documentary series from noted filmmaker RJ Cutler (*The War Room*) that will explore race relations in the U.S. Scheduled to air sometime in 2006.

THE TEN COMMANDMENTS Actor George Clooney and director Steven Soderbergh oversee this 10-part miniseries with a story about each commandment. In development.

CRASH Paul Haggis, director of this summer's film of the same name, is working on a series based on the movie.

EDDIE IZZARD The cross-dressing British comedian will star in a drama series about Gypsies in America. In development.

Data: FX

University of Southern California, Marshall School of Business

Los Angeles, CA • 213.740.8885 • www.marshall.usc.edu

USC is the only top-ranked private research university in the Western United States offering an undergraduate major in business. The university's commitment to excellence in undergraduate education earned USC the Time/Princeton Review's "College of the Year" award in 2000. The 2001 "How To Get Into College" Newsweek/Kaplan Guide chose USC as one of America's nine "hottest schools," and the AAC&U named USC a "Leadership Institution" in undergraduate education.

The USC Marshall School of Business is one of the few business schools that combines a diversity of students, world-class research and scholarship, and excellence in business education. Undergraduate core requirements provide students with a comprehensive intellectual foundation and Marshall students have complete access to the rich variety of courses and minors offered across USC. Located in Los Angeles, one of the world's most diverse cities and gateway to the Pacific Rim, USC Marshall is dedicated to strengthening its position as a global center of business education. The university also maintains one of the largest, most supportive alumni networks in the world.

Bridge and Hoffman Halls — two of the main buildings of USC Marshall — feature state-of-the-art teaching facilities.

Business Degree Program

2006 U.S. News & World Report ranked USC Marshall's undergraduate program as #9. Students pursuing a degree in Business Administration or Accounting combine in-depth knowledge of theory, real-world practical learning in business, and a solid foundation in the liberal arts and sciences. This preparation uniquely equips graduates to deal with a rapidly changing, complex world. Focusing on leadership development and the acquisition of managerial skills, Marshall emphasizes communication, analytical decision making and teamwork. Exchange programs give exposure to the multicultural nature of global business. The integration of broad-based business knowledge and an area of expertise prepares students for productive careers or for undertaking advanced professional studies.

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Washington State University

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Washington State University has recently ranked among the top 50 public research universities in the nation. WSU offers cutting-edge programs in 245 undergraduate fields of study, and outstanding facilities with state-of-the-art technology.

With world-class faculty and a vibrant campus community, the University is committed to providing the best undergraduate experience at a research university. Rich discussions, leadership opportunities, internships, and study abroad challenge and reward WSU students. They benefit from an intellectually stimulating environment, interactions with diverse, high-achieving classmates, and faculty and staff dedicated to each student's personal and academic success.

The main campus is located in southeastern Washington, a region of extraordinary beauty and abundant recreational opportunities, with rolling hills, pristine lakes, and nearby mountains. Students thrive in the college-town atmosphere with Pac-10 athletics and a community that truly appreciates its University.

The College of Business and Economics

The College is developing leaders and driving innovation through active, hands-on learning and world-class research.

Top finance students manage a $1 million portfolio and have beaten the S&P 500 by over 6% since fall 2001. Accounting students intern nationally. Hospitality students run on-campus businesses and receive multiple job offers.

Facilities with cutting-edge, wireless technology promote real-time interactions between students and international executives. The new Carson Center for Professional Development focuses on skill building for personal and professional success.

Many of the College's nine undergraduate majors are within nationally ranked programs. International Business is traditionally in the top 20 (*US News and World Report*). *Entrepreneur Magazine* rated the Entrepreneurship emphasis program as the state's best. Hospitality Business Management has been ranked #1 in career services.

Washington State University
College of Business and Economics

2005 Fall Undergraduate Review
A Guide to Featured Degree Programs

Univ. of Colorado at Denver & Health Sciences Center

Denver, CO • 303.556.2704 • www.cudenver.edu

Set your sights on the Mile High City and a university that's far above the ordinary! The Downtown Denver Campus of the University of Colorado at Denver and Health Sciences Center serves as the intellectual and technological centerpiece of one of America's most flourishing cities. As the only comprehensive public university in Denver, UCDHSC provides students with opportunities to enhance their lives and careers.

With the Rocky Mountains as a majestic backdrop, our campus is located in the heart of downtown Denver, surrounded by an abundance of recreational, cultural, academic, and professional outlets. The campus provides a unique blend of metropolitan buzz and easy access to outdoor recreation. It is within walking distance of all of the professional sports venues, the Denver Center for Performing Arts, parks, museums, theaters, and an eclectic assortment of restaurants, coffeehouses, and shops. At the same time, it has close proximity to some of the best skiing, snowboarding, camping, hiking, whitewater rafting, and rock-climbing in the world. Our first student housing opens in Fall 2006!

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More than 15,000 students seek degrees in over eighty program areas, spanning a wide range of fields and disciplines recognized nationally for producing leaders in business, industry, and government.

Undergraduates and graduates alike enjoy small class sizes and personalized instruction in our College of Arts & Media, Business School, College of Engineering and Applied Science, and College of Liberal Arts and Sciences. Those seeking graduate only education are drawn to programs in our College of Architecture and Planning, School of Education, and Graduate School of Public Affairs.

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Musicians Institute

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With accredited full-time programs in guitar, bass, drums, keyboards, vocals, recording engineering, original music production, guitar making, music business and music video/commercial directing, Musicians Institute is the world's most innovative school of contemporary music.

MI's educational philosophy is built around intensive, hands-on training taught by working professionals. Continuous application of practical skills in professional settings using industry-standard equipment prepares students for the reality of careers in the contemporary entertainment industry. MI graduates are working on stage, in recording studios and behind the scenes all over the world.

MI's facilities on Hollywood Boulevard include world-class professional recording studios, multiple project studios, dozens of digital audio workstations, film production and HD editing systems, a 500-seat concert facility, and a wide variety of performance stages, class/rehearsal rooms, and practice labs. If you're looking for your place in the music industry, MI is the place for you.

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MI's Bachelor of Music program (accredited by the National Association of Schools of Music) offers a unique blend of conservatory-style training and contemporary music performance. Students of guitar, bass, drums, voice and keyboards enjoy small, intensive classes in arranging, recording and multimedia taught by active professionals. Weekly private lessons and ensembles culminate in challenging student-directed performance juries. MI's one-of-a-kind, total-immersion music environment provides training and practical experience in the full range of contemporary styles. World-class visiting artists offer inspiration and unique insights into the music profession. At MI, you don't just study music, you live music.

MUSICIANS INSTITUTE

Bryant University

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Bryant's unique blend of business, liberal arts, and technology is integrated into all undergraduate programs - Applied Psychology, Business Administration, Communication, Information Technology, International Business, and Liberal Arts. The Graduate School confers masters degrees in Business Administration, Information Systems, and Taxation.

Bryant's scenic New England campus is minutes from Providence and an hour from Boston. With 82 percent of the students living on campus, there are numerous organizations, clubs, and activities in which to participate. Leadership opportunities and community service activities abound. NCAA Division II varsity athletics, as well as intramural and club sports are popular. Bryant has internship and recruiting relationships with more than 300 companies and offers a variety of career services programs.

Bryant University. The Character of Success.

The B.S. in International Business

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Bryant's Bachelor of Science in International Business (BSIB) prepares you to meet the challenges of a complex global environment by exposing you to international business strategies as well as the cultural and historical contexts in which you'll live and work. Students take core international business courses and choose a specialized concentration in computer information systems, finance, management, or marketing. The business core combined with a strong liberal arts component, a language minor, and a required international experience provide you with the expertise and depth of understanding that is highly valued by potential employers.

Bryant University

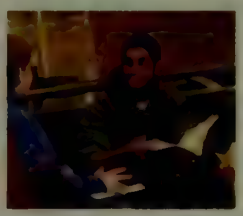
The Character of Success

Worcester Polytechnic Institute

Worcester, MA • 508.831.5218 • www.wpi.edu/business

Founded in 1865 as one of the nation's first private technological universities, WPI is consistently ranked among the top 55 national universities by U.S. News & World Report. With its novel, hands-on approach to education, WPI provides a learning experience that seamlessly integrates theory and practice. Building on a solid grounding in the fundamentals of science, engineering, management, liberal arts, and social sciences, students apply their knowledge through interdisciplinary projects and projects specific to their major. Two-thirds of WPI students complete their projects off campus at centers in the United States and on five continents.

On its 80-acre campus, WPI offers more than 50 undergraduate and graduate degree programs, leading to the B.S., M.S., M.E., MBA, and Ph.D. Students enjoy a vibrant campus life, with 200 clubs and activities, including varsity and club sports, fraternities and sororities, and music and theatre groups.



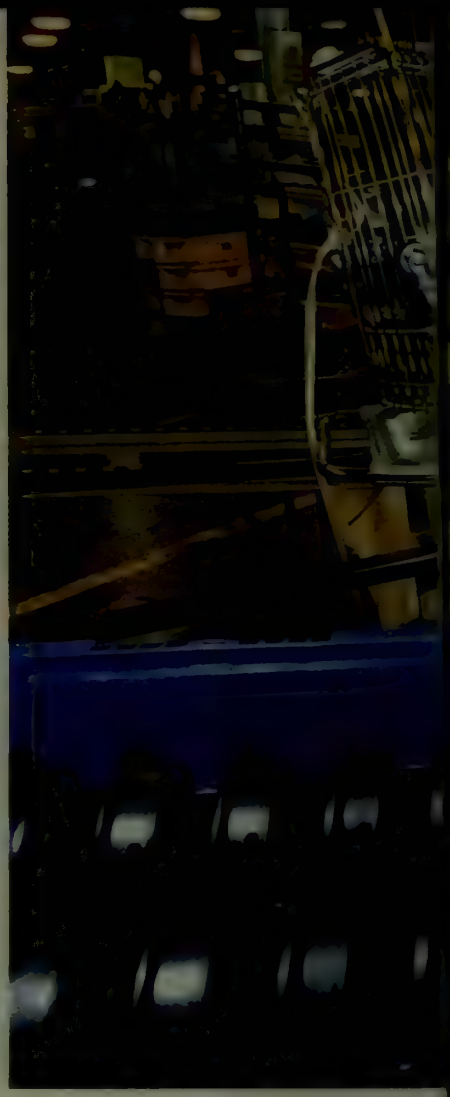
Undergraduate Management Programs

A key factor of success for today's college graduate is understanding both business and technology and how to make them work together successfully. The Department of Management, WPI's nationally ranked answer to the traditional business school, has been doing that productively for over 40 years. When combined with WPI's unique project-enriched education, the Department's students learn to think creatively and critically, present effectively, work as consultants to solve meaningful problems for organizations, and understand business beyond the borders of the United States. The result is that they are recruited heavily and earn substantially above (national) average salaries.

WPI

Spin-Offs That Won't Go Away

Why Delphi and Visteon continue to haunt General Motors and Ford



LIKE GROWN CHILDREN badgering their parents for handouts, auto-parts companies Delphi and Visteon keep turning up on the doorsteps of GM and Ford. Spun off from General Motors Corp. in 1999, Delphi Corp. is now threatening to file for bankruptcy court protection by Oct. 17 if it doesn't get a truckload of GM's money and union concessions. And Visteon Corp., spun off by Ford Motor Co. the year after, is dumping 24 mostly money-losing plants on Ford this month as part of its second bailout in two years.

The two parts makers remain GM's and Ford's largest suppliers, but there's a bigger reason why the auto makers are still on the hook for these offspring: Except for their stock, they never completely cut all ties to make them independent companies. Visteon began life without full-fledged administrative systems such as payroll, information technology, and accounting—it paid Ford to do that work. Next month, Ford will assume responsibility for the retirement benefits of Visteon's union workers and GM would pay benefits to Delphi retirees if the parts maker fails. One industry watcher and consultant, Maryann N. Keller, says that because so many Delphi executives were GM lifers, the company was reluctant to drop unprofitable business from GM.

Indeed, Delphi and Visteon—which together employ more than 250,000 people and book nearly $50 billion in annual revenue—may have been destined to fail. GM and Ford lumbered them with huge labor costs while extracting promises from them to cut their prices. "These companies were not spun out as viable businesses," asserts Keller. Ford argues that Visteon did have a fighting chance to succeed, but, like other suppliers, it was hit by many problems, such as falling Big Three sales and rising costs for commodities. "A lot has changed in the intervening years," says Ford spokesman C car Suris. GM declined to comment.

Now some of the costs that the au makers tried to move off their books coming right back to them, making whole spin-off exercise something o charade. GM may well have to cough up billion to $3 billion for Delphi over next couple of years, says Brian A. Joh son, an auto analyst at Sanford C. Be

Ties That Bind

In 1999 and 2000, GM and Ford spun off their parts businesses into separate companies owned completely by outside investors. But the auto giants remain linked to their offspring:

STEVE MILLER
CEO, Delphi

GM

- Responsible for retirement benefits for former GM employees working at Delphi if Delphi is unable to pay
- Pays $500 million a year for health and retirement benefits at Delphi and other divested businesses
- Promises to purchase an undisclosed volume of parts from Delphi in exchange for low prices
- Considering new deals and financing to help restructure Delphi, which gets half its revenues from GM and is threatening bankruptcy

MICHAEL JOHNSTON
CEO, Visteon

FORD

- Supplies one-third of 53,000 hourly workers in Visteon factories, under agreement with union*
- Provides information technology and other general administrative services to Visteon**
- Regularly renegotiates commitments to buy Visteon products, providing 65% of Visteon sales
- Agreed to $1.5 billion in costs to take back and restructure 24 Visteon plants in 2005

*Factories set to revert to Ford Sept. 30 ** IT work phased out in 2005 **Data:** Company reports

PRICEY LINE Delphi workers, as in this Flint (Mich.) factory, cost $65 an hour, says CEO Miller

in & Co. And in agreeing to take back 24 teon factories and their 17,000 workers, rd said in May that it will book about $1 lion in restructuring charges. Ford al- dy took a $1.6 billion Visteon-related arge in 2003. Plus, the company may ve to continue paying part of the wages nion workers in order to sell the plants other suppliers. As matters stand, it ex- ts to lose up to $450 million on the fa- ties this year and next. These are bur- ns that the companies can ill afford: In North American market for the first lf of the year, GM lost $2.5 billion and rd $244 million.

CONOMIC SUICIDE"

CK AT THE HEIGHT of the 1990s bull rket, the spin-off stories sounded swell both GM and Ford and for shareholders the new parts outfits. The auto giants d they would shed highly paid workers, efficient plants, and some retirees—and free to buy parts from other companies th lower costs. "There was no logic to ying those kind of wages for parts anufacturing]," says one former Ford ecutive. "It was economic suicide. Once M did it, we had to."

And at Delphi and Visteon, profits were rolling in and balance sheets were healthy, thanks to strong sales of SUV parts and pension plans that were largely funded by the soaring stock market. Also, both companies boasted hot new technologies that they said would attract orders from the likes of Toyota Motor Corp., Honda Motor Co., and other auto makers once they were independent. And both pledged to boost business overseas, where they weren't tied down by United Auto Workers contracts. Visteon Chairman Peter J. Pestillo, a former Ford vice-chairman and labor relations chief, declared at Visteon's launch: "This opens the door wide to new business." Visteon's shares jumped at first, from $13 to $21 in 13 months, before plummeting, while Delphi's shares fell along with GM's and are now off 75%.

Both parts makers are seeking billion-dollar-plus boosts

Delphi tried to play down the labor costs in presentations to institutional investors and analysts during a roadshow. Two analysts who attended recall that J.T. Battenberg III, a longtime GM official who recently retired as Delphi's chairman and CEO, argued that Delphi's average wage was competitive with other suppliers'. Trouble was, the average included the low rates in Mexican and Asian plants. His point, says Joseph S. Phillippi, president of consulting firm AutoTrends Inc. and a former Lehman Bros. analyst, was that Delphi could lower costs by moving more factories overseas. But Keller adds: "It didn't show that the bulk of the business was in noncompetitive factories." Battenberg declined to comment. Delphi said it could not comment without checking its records first.

PREMATURE BIRTH

RIGHT FROM THE START, the U.S. plants of both Delphi and Visteon had a tough time winning new customers. Because of union contracts, the parts companies inherited their parents' outsize labor rates—now $22 an hour, compared with about $15 at parts companies Johnson Controls Inc. and Lear Corp. Adding in benefits, Delphi's workers cost $65 an hour, says Delphi Chairman and CEO Robert S. "Steve" Miller. That's more than twice what rivals have to stump up. And if GM and Ford thought their parts operations were too expensive, so would potential customers such as Nissan Motor Co. or BMW. Since the spin-offs, additional sales to other companies haven't offset declining revenues from the parents. Says Joseph W. Cornell, president of Spin-Off Advisors LLC: "When GM and Ford did this, you could see that it was more to benefit the parents than to unleash good businesses that would blossom."

Many of Visteon's problems can be chalked up to its premature birth. For the first 18 months, Ford wrote the paychecks for white-collar workers. The company's offices were spread out among 26 different buildings, forcing managers to drive all over the Detroit area just to attend

JOINING THE BIG BOARD Then-CEOs Pestillo of Visteon (in 2000) and Battenberg of Delphi (in 1999) ring the bell

meetings. It didn't have a full-blown marketing and sales operation and had few relationships with other auto makers because it made 90% of its sales to Ford. Salespeople, to win new customers, sometimes quoted prices that were too low to cover costs. In the fall of 2000, Visteon's then-president, Michael F. Johnston, and Robert H. Marcin, senior vice-president of corporate relations, went to Tokyo to build ties with Nissan—and ran into a buzzsaw of criticism from Nissan's top purchasing executive, Marcin recalled later. The Nissan official said two Visteon salespeople had visited him that day and neither knew the other was coming. And he told them that he didn't believe Ford had relinquished control of the company. He feared that Visteon would hand over Nissan's product plans to Ford. Says Merrill Lynch & Co. analyst John A. Casesa: "Visteon never had the tools to start with."

Visteon still depends on Ford for 65% of its sales and has lost $3.4 billion since 2002. And Ford has been a tough customer: It once gave Delphi a big order instead of Visteon to save 3¢ apiece on car stereos that cost several hundred dollars each, says a Visteon executive.

Freed of its uncompetitive plants, Visteon now expects better times. Most of its remaining business comes from foreign markets where it produces parts and doesn't have to deal with the UAW. In fact, Visteon is now one of the largest makers of interior systems for cars in China. "Tomorrow is really different for us," crows Visteon Chairman and CEO Mike Johnston.

Now Johnston's problems are reverting to Ford. Under its plan to unload or revamp the plants it's getting back from Visteon and to buy out employees, Ford hopes to reap $600 million to $700 million a year in lower supply costs by the end of the decade, says Ford Chief Financial Officer Donat R. Leclair. That's the plan, anyway. Says Leclair: "It assumes a whole series of things."

DELPHI'S DEMANDS

THOUGH IT WAS far better prepared than Visteon for its kick out the door, Delphi today is in much worse shape than its rival. It lost $608 million from operations in the first half of the year, vs. $288 million at Visteon. Its pension plan will eat up $1.1 billion in cash next year, says Standard & Poor's debt analyst Martin King.

The future for Delphi and Visteon lies in lower-cost plants abroad

Delphi hired Miller, a turnaround specialist, in June after an accounting scandal that, in part, involved transactions with GM. He's calling on GM to foot at least part of the bill for rescuing Delphi, either by taking workers back, buying them out, or paying Delphi more for parts. He has also told UAW leaders that Delphi must have a new labor agreement to cut wages, benefits, and jobs, close plants, and nix the long-standing practice of paying workers 75% of their wages after they're laid off. Its 4,000 furloughed workers are costing Delphi $400 million a year, he notes. Says one union official: "He has demanded everything except making the workers bring their own materials to work to make the parts." Miller respor "Should we fail in our discussions v GM and the UAW, we will have to con er [bankruptcy court] reorganization.

It turns out that while GM was rea ing Delphi for the spin-off, it was preparing for a quick switch of busir away from Delphi. The parts maker getting about a quarter of its busir from outside GM; now it's 51%. " thought we had a good long runway exit some product lines, says James Bertrand, president of Delphi's Auto tive Holdings Group, the unit that m ly supplies GM. The group's 11 manu turing sites are set for restructuring, s or closure. The plants, some mak commodity products such as air fil and spark plugs, account for 9% of I phi's revenue but most of its losses. Mi is pushing GM and the UAW for con sions to make the plants viable. One p sibility: GM would give workers a o time cash payout of $75,000 or more, the workers would accept lower wage

Meanwhile, Delphi has diversified i electronics such as satellite radio medical devices. "Delphi is a tale of t companies," says Miller. "Half is p itable, growing, and a technology lea The other half, through its legacy fr GM, has costs that are not competitiv

The ugly half may land the compan bankruptcy court before Oct. 17, the that tougher corporate bankruptcy ru take effect. Either way, Miller says he transform Delphi. GM's response: "W in discussions with Delphi," Vice-Ch man and CFO John M. Devine told vestors on Aug. 30. Then he added: "T said, we'll do what's best for GM." course, that's what GM executives w doing from the get-go. ■

–By David Welch in Detroit d David Henry in New Y

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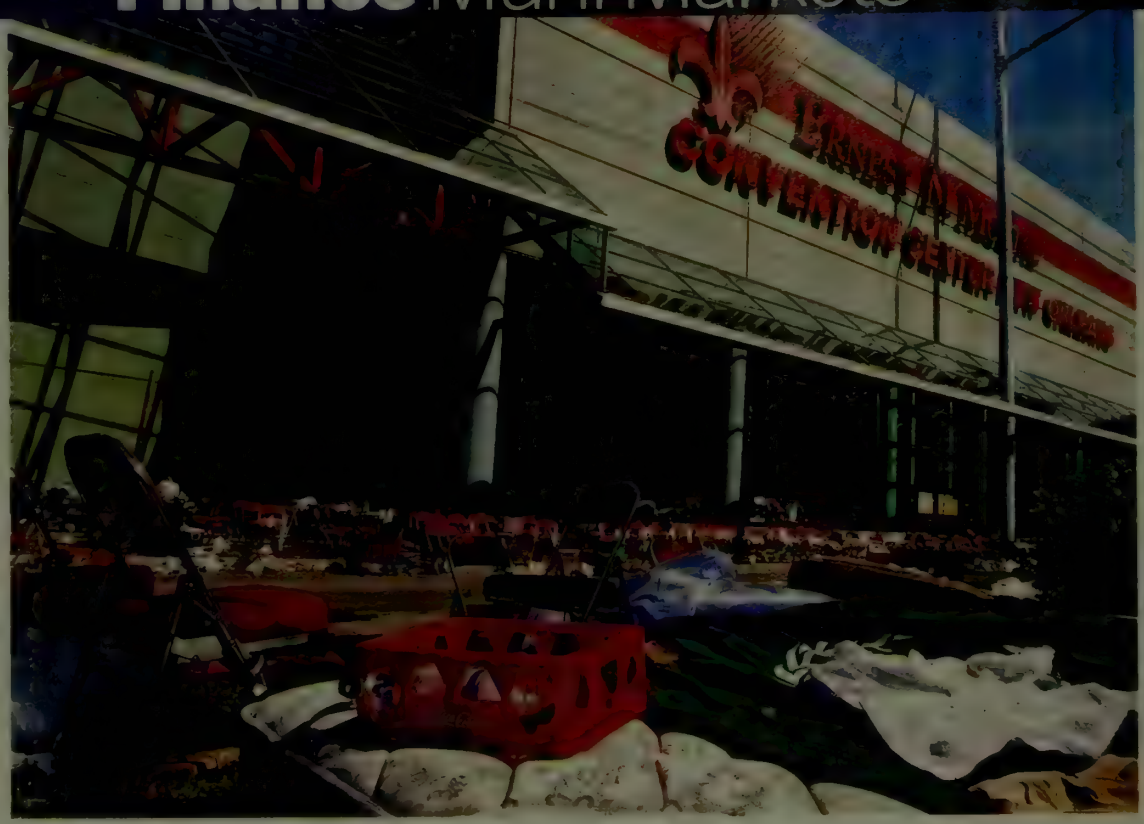

LONG HAUL Convention Center bonds rely on tourist and hotel taxes

Why These Bonds Will Stay Afloat

Federal aid and rainy-day funds should ease fears about Gulf Coast munis

AT LEAST ONE COMMENTATOR is forecasting a coming Armageddon in the municipal bond market in the wake of Katrina. No doubt about it, the fiscal systems of states and cities in the path of the deadly hurricane are in tatters along with much infrastructure bankrolled by muni finance. With the tax base of wide swaths of the Gulf Coast in ruins, defaults can't be far behind, can they? Not if Louisiana State Treasurer John N. Kennedy has anything to do with the matter.

Kennedy told *BusinessWeek* Louisiana has ready cash available, from its own resources, totaling $6 billion. That's more than three times the $1.8 billion the state owes, and an even larger multiple of its annual outlays to pay interest and redeem maturing bonds. Also, it has two "very substantial" lines of credit with banks and is negotiating a third. And he's dickering with Washington for favorable bond-financing terms of the type New York got after 9/11. Predictions of defaults are "nonsense on a stick," Kennedy said in a telephone interview. "The state is prepared to meet all of its current and future obligations."

Of course, bonds issued by cities are separate. And on the face of it, there's plenty to scare investors. "I'm not trying to sugar-coat this. Our economy has been disrupted," Kennedy said. Almost one-third of Louisiana's $125 billion of annual income is produced in New Orleans. The Crescent City has $513 million of outstanding bonds, and its water and sewer authority another $198 million, according to Moody's Investors Service. Another half a billion dollars of bonds that funded the city's Ernest N. Morial Convention Center must be paid with sightseeing and hotel taxes that may be sharply down for many months. Market fears are palpable: On Sept. 7, the center's bonds traded nearly 5% down from the last trade two weeks before Katrina.

But if history is any guide, federal assistance will help smaller localities sidestep defaults, argues Kennedy. Besides, some cities may be up and running sooner than expected. New Orleans' French Quarter and Garden District avoided most flooding damage and electricity has been restored to the main business area, once under a few feet of water.

So how can Louisiana, with some of the lowest debt ratings among all the states, muster so many resources with tax revenues off-line? It has $387 million in its "rainy day" fund, another $3.5 billion in trust funds that can be tapped with the approval of state legislators, and a $2 billion agreement to borrow against its securities portfolio, Kennedy says. Talks with Congress and the Federal Reserve are underway to set up further backing for smaller issuers.

Federal aid to the disaster area could be modeled on the government's help to the New York region after September 11. As well as direct grants, aid was available to cover local bond payments until tax revenues recovered. Congress also set up an $8 billion Liberty Bond program that allowed commercial projects to issue tax-free municipal bonds. Typically bonds financing such private activities can be used only to finance municipal structures like airports. Liberty Bonds allowed commercial and retail rebuilding projects to lower interest costs and tap a $2 trillion market. Another tactic used

THE STAT

$6 Billion

Ready funds Louisiana has available to service state debt

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in New York that could be repeated would relax limits on local issuers refinancing their bonds to lower interest costs. Kennedy says he's investigating whether a hurricane recovery authority could be set up to issue bonds as well. "Throughout history, the United States has provided very large support to local governments not just for emergency response but also to rebuild and repair," says Robert Kurtter, senior vice-president at Moody's.

NOT PROBLEMS

THE LIBERTY BOND program caused some controversy over the use of its proceeds for projects seemingly unrelated to terrorist attacks, such as a power plant in Queens and a bank office in Brooklyn. The state and city of New York have also had a tough time allocating money. More than two years after the program was approved only $2.3 billion had been spent. But neither issue should pose much of a problem for the Gulf Coast, where the damage is far more widespread and the need more urgent.

Kennedy plans to be ready when assistance becomes available. He met with 75 bond underwriters, trustees, and attorneys on Sept. 6 to draw up a list of every bond payment for every issuer in the state due through the end of the year. The idea: Use the list to line up assistance before any payments are missed. Much of the debt is also backed by bond insurance companies like MBIA Inc. and Ambac Financial Group Inc., so payments will be covered even absent a federal program. Shares of MBIA have dropped 5% since the hurricane hit, while Ambac has lost less than 2%, reflecting investor confidence that the bond insurance industry has ample capital to pay any claims. "The insurance industry has proven its worth in the past in situations like this," says Rick Marrone, head of the municipal bond investment unit at Evergreen Investment Management Co.

And as the regional economy recovers, rebuilding can be paid for with new bonds. The municipal market can handle large borrowings, as issuers have churned out over $300 billion of total new debt during every year since 2001. For now, muni investors haven't panicked. In general, says Marrone, "[Katrina is] just not having much of an impact on bond prices." And if Kennedy gets the help he's seeking, the muni market could dodge a financial hurricane. ■

–By Aaron Pressman in Boston

Still for Sale: One Storm-Damaged Bank

Capital One's takeover of New Orleans' Hibernia, though delayed, will help the buyer

AT THE VERY LEAST, Capital One Financial Corp.'s planned $5 billion purchase of New Orleans-based Hibernia Corp. looks like a serious case of bad timing. Scheduled to close Sept. 1, three days after Katrina hit, the deal is now delayed for a few months so shareholders can vote on a new price—a sharp 9% cut in the pre-hurricane tab.

Even with the discount, some analysts wonder whether it still makes sense for McLean (Va.)-based Capital One. Sixty of Hibernia's 321 branches have been shut since the storm, an there's no telling when they'll reope Meanwhile, the bank is allowing cus tomers to delay payments on consume and small-business loans of up to $ million until January—a big hit to rev enues and profits. Then there's th huge cost to rebuild. "Capital One taking on a much larger merger-inte gration challenge than it originally an ticipated," says Kathleen Shanley, sen ior analyst at Gimme Credit Finance.

Capital One may have little choice. Fo nearly a year, it has tried to diversify be yond its lucrative credit-card business b buying a bank. To renege might hurt i chances at futu deals. "It would loo bad as a nation brand to just term nate the merger," say Linda Varoli, senio analyst with independent researche Merger Insight in New York. The $22 million fee for walking away would als be painful. "There's a lot we can do to gether," Hibernia CEO Herb Boydsto told *BusinessWeek*.

More important, there are good, strate gic reasons for the deal. A bank will bolste Capital One's credit-card distribution. also gains $11.85 billion in deposits which should lower its cost of funding.

Later, Hibernia should benefit from de mand for loans to rebuild homes an businesses. Still, the bank's most valuabl asset may be its potential: Hibernia ha been expanding into the hot Texas mar ket, where thousands of Louisianans hav fled and many are expected to stay. ■

–By Mara Der Hovanesian an Nanette Byrnes in New Yor

TRASHED Sixty of Hibernia's 321 branches have been shut

Big Deal
In the Big Easy

Why Capital One's $5 billion purchase of New Orleans' Hibernia Bank still makes sense after Katrina:

- Capital One gets a bridgehead into the white-hot Texas banking market, where Hibernia has a third of its assets
- The deal allows it to diversify away from being purely a credit-card company making it less of a takeover target itself
- Financing costs will fall because Hibernia has a higher credit rating than Capital One, which is two notches above junk

Data: BusinessWeek

BusinessWeek online For an online interview with Boydston, as well as for Q&As with Kennedy and Boydston, go to www.businessweek.com/go/katrina

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JAPAN

CIVIC-MINDED AT HONDA

The carmaker is betting its restyled compact will lure Americans

ON OCT. 23, THOUSANDS of young people are expected to converge on a shopping center parking lot somewhere near San Francisco. But they won't be there to buy jeans or shoes or iPods. Instead, they'll hear a concert by The Black Eyed Peas—and, Honda Motor Co. hopes, check out a parade of new Civic sedans. The concert, one of a half-dozen similar events planned for this fall, is part of a guerrilla marketing campaign to build buzz around the Sept. 15 launch of the restyled compact. "We're trying to connect Civic with a new generation," says John W. Mendel, a senior vice-president at the Japanese auto maker's U.S. sales subsidiary. "It's a very different direction for Honda."

The company could use a change of course in the U.S. While the Civic is still profitable, U.S. sales this year will tumble to 280,000, down from more than 335,000 in 1998, brokerage CLSA estimates. Inexpensive Korean imports such as the $10,000 Hyundai Accent have undercut the Civic, and its share of the U.S. compact market fell to 11.7% in the first half of 2005 from 13.7% in the same period last year, according to market watcher Ward's AutoInfoBank. And both the Civic and the Accord midsize sedan have become tougher sells as Americans have turned to SUVs and pickups. But while Honda recently joined the trend with its Element crossover, Pilot SUV, and Ridgeline pickup, it's not about to abandon the core of its U.S. business. "The Civic and Accord are our bread and butter," says Honda President Takeo Fukui. "We still have high expectations for them."

The new Civic is central to Fukui's plan to recreate the magic that brought generations of young American car buyers to Honda's doorstep. The latest iteration of the once dirt-cheap hatchback features a racing-car-like sloped windshield, an extended wheel base, and a revved-up engine. Prices are expected to be about the same as this year's model—starting at $13,660 and topping out at $21,000 for the gas-electric hybrid version—but include extras such as standard side air bags, a first among vehicles in the Civic's class.

Fukui is out to recreate the magic that made the car a hit in the U.S.

Honda is also reaching out to "tuners," twentysomething car nuts who modify and race compacts. Once Honda loyalists, many tuners scoffed at the current Civic, which they thought suffered from dowdy styling and lacked oomph. Today, the company is betting that it can quiet any doubters with a high-performance version called the Civic Si that features a 197-horsepower engine, a six-speed transmission, and standard 17-inch alloy wheels. "It looks like it's going to be a very stron winner for us," says Wade Shackelford, sales manager at Carey Paul Honda in th Atlanta suburb of Snellville, Ga. "Th tuner crowd is very big, [and] there's huge market in Honda for that." The aut press likes it, too. The new model "shou prove a segment leader—if not a segmen buster," AutoWeb.com writes.

Honda expects the new Civic to goos its results. Earnings in the U.S.—th source of about 75% of Honda's glob profits—have come under pressure. In th quarter ended in June, Honda reported 10% fall in North American operating in come, to $662 million. The main reaso is that Honda's givebacks shot up to a average $1,000 per vehicle in the la quarter, from about $610 in 2004, say brokerage Nikko Citigroup Ltd. That still less than most rivals, but even so it beginning to sting. Investors, thoug seem to like the new look. Honda's share are up by 12% this year.

"GRIN AND BEAR IT"

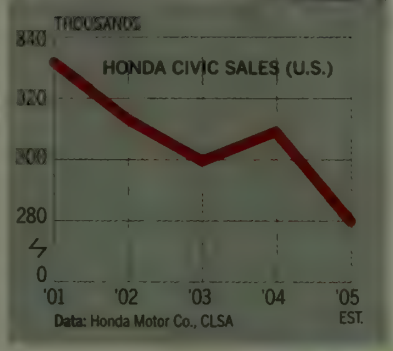
WHILE SHAREHOLDERS are clearly ex cited by the new Civic, the stock price ha also been helped by strong results else where that have offset the decline i North American earnings. In Japan, fo

REVVED UP
The new Civic has more power

stance, its Airwave station wagon and epwagon minivan have been hits. Eu-pe is another hot spot as demand soars diesel-powered Accords and CR-V mpact SUVs. That positive news helped nda post a 6.5% rise in operating prof- to $1.55 billion. The mpany also raised its l-year earnings fore-st to $6 billion, up 4% over 2004, on a % gain in sales, to 5.7 billion.

Still, it's unclear ether Honda can roll ck incentives. Detroit keeping up the pres-re with deep dis-unts, even as Fukui s tried to hang tough th the brand new dgeline. The refusal boost incentives on e pickup has pushed dgeline sales down about 4,000 a nth—well below an tial target of 5,000. wonder. The Ridge-e, which starts at 7,700, typically costs nearly $10,000 more than similar rivals such as the Toyota Tacoma and Nissan Frontier, once incentives are factored in. Yet Fukui insists slower sales are acceptable to stay out of a price war he believes has nearly run its course. "Better to grin and bear it, because once you start cutting prices, there is no going back," he says.

NO TRACTION



At the same time, Honda is looking to emulate the surprising success Toyota Motor Corp. has had in attracting entry-level buyers, especially with its Scion series, starting at $12,000. Just as Toyota has done, Honda is reaching into its stable of low-powered-but-stylish models previously unavailable in the U.S.—in this case, the Fit, a 1.0-liter-class car dating to 2001. The idea is to offer something to budget-minded buyers who have been priced out of compacts like the Civic. The Fit sells for roughly $10,000 in Japan, but pricing hasn't yet been set for its U.S. launch next year. It will compete not only with the Scions, but also another new Japanese import—Nissan Motor Co.'s Tiida, which could be bound for the U.S. market as soon as next year.

U.S.-BOUND: THE FIT

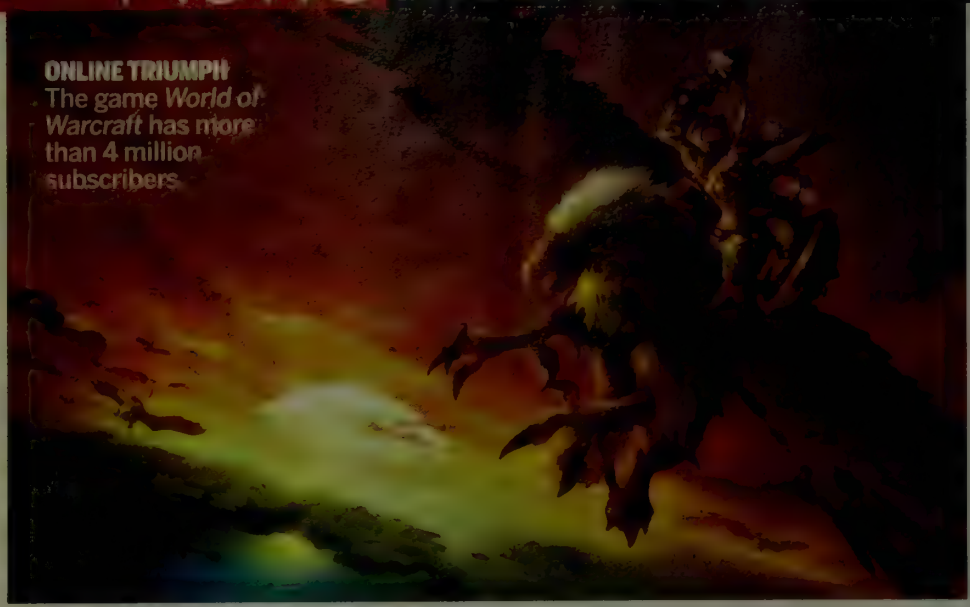
LURING THE YOUNG

THE FIT MAY BE a hit with those worried about global warming or higher pump prices, but some fret that it could steal sales from the pricier Civic. The subcompact gets about 57 miles per gallon—topping even the hybrid Civic—and has cannibalized sales of the Civic in Japan. But Honda seems willing to risk such a tradeoff to attract new buyers. "[What's] driving this is the search for the younger customers," says Chris Richter, an analyst at CLSA Asia-Pacific Markets in Tokyo. "If there is a demand for smaller cars and you don't provide them, then somebody else will."

At the same time, Honda isn't writing off heavy metal. Fukui hints that he may introduce a V-8 engine and more high-powered rear-wheel-drive cars. Honda has resisted those moves for years, citing the cost of upgrading existing plants. With Honda's factories near capacity, though, analysts say the company may be thinking now is the time for a new plant capable of making bigger engines and beefier cars and trucks.

That would be a big departure from Honda's roots as a maker of compact cars—and could backfire if gas prices remain near their current stratospheric levels. But the U.S. sedan market has been shrinking for years, and even The Black Eyed Peas and a snazzy new Civic might not be enough to change that. So Fit subcompacts and Ridgeline pickups could well point the way for Honda. ■

–By Chester Dawson in Tokyo, with Kathleen Kerwin in Detroit and Rishi Chhatwal in Atlanta



ONLINE TRIUMPH The game *World of Warcraft* has more than 4 million subscribers

FRANCE

VIVENDI'S NEW VITALITY

Three years after Messier, it's finally cashing in on his digital media vision

FROM SAN DIEGO TO SEOUL, more than 4 million people shell out an average of $15 a month to wage battle against orcs, trolls, and the undead in the megahit online game *World of Warcraft*. In France, cell-phone users pay $8.70 a month to watch TV shows on their handsets. Music lovers worldwide are spending more than $300 million a year to download songs, music videos, and cell-phone ringtones. After years of false starts for the industry, customers are finally paying for digital entertainment, wherever and whenever they want it. And guess who's cashing in: Vivendi Universal.

That name ring a bell? *Mais oui*—it's the former French utility that nearly collapsed after then-CEO Jean-Marie Messier tried to transform it into a global powerhouse in digital media. Three years after Messier's ouster, Vivendi's currency-adjusted first-half revenues rose 7%, to $11.4 billion, and the company is forecasting a 37% jump in profits for the full year, to $2.2 billion.

More important, the Paris company is in pole position to capitalize on digitized entertainment. Its Universal Music Group was the first music company to sign on with Apple Computer Inc.'s popular iTunes venture two years ago. Now it's promoting music and ringtone downloads to mobile operators worldwide. The Vivendi Universal Games unit is planning to roll out games for mobile phones, too. "A significant part of our growth will come from these intersections" between new technologies and Vivendi's digital storehouse, says CEO Jean-Bernard Lé

Not long ago, such optimism wou have seemed ludicrous. To pay down a $ billion debt load, Chairman Jean-Re Fourtou and Lévy sold off some Messier's prize acquisitions, includi Universal Studios Inc. and publish Houghton Mifflin Co. Yet some gems we hidden in the wreckage. One was Blizza Entertainment, the Irvine, Calif., outfit th created *World of Warcraft*. Since its N vember launch, *World of Warcraft* has l come the best-selling online game in hi tory, with analysts forecasting $2 million in revenues this year and a 35 profit margin. "It has an excellent plot a elaborate graphics," says Park Kwa Hoon, a carpenter in Seoul who is amo some 550,000 Korean players. Some cre it goes to Vivendi's new managemen which despite dire straits did not lean Blizzard to speed up the game's relea "They understand that it sometimes tak time to create a great game," says Blizza President Mike Morhaime. Likewise, Un versal Music executives say they have h ample budgets to sign new artists, ev when sales plunged.

MOBILE MUSIC

THE UNIVERSAL MUSIC Group, like t rest of the music industry, has been wa ing its version of mortal combat agai piracy. But even with sales weak, Unive sal took the risky step of signing Mari Carey after EMI Group dumped her 2002. Smart move, considering Care new album, *The Emancipation of Mi* has sold more than 2 million copies sin April. Universal's new mobile group h also signed deals with Yahoo!, MSN, a iTunes for music video downloads a pay-per-views. Digital distribution no accounts for 5.5% of sales. "You can on grow revenues when you have somethi that folks want to hear," says Univers Music CEO Doug Morris.

If Vivendi is admired for its cr ativity, investors are still a bit pe plexed by its overall corporate sion. There's little overlap betwe the entertainment properties a the telephone business, which st supplies about half of revenu Many analysts say the compan share price, which is up just 8% th year—about half the rise of the Pa bourse—suffers because investo regard it as unfocused. Focus needed. But Vivendi is definite back from the brink. ■

–By Carol Matlack in Paris a Ronald Grover in Los Angeles, wi Moon Ihlwan in Seo

Vivendi Rising

TELECOM
2005 operating earnings*: $3.82 billion, up 30%

MUSIC
2005 operating earnings: $572 million, up 35.5%

PAY TV
2005 operating earnings: $223 million, down 5.5%

GAMES
2005 operating earnings: [illegible] million, up from $228 million loss in 200[illegible]

CEO LEVY

*2005 figures are estimates **Data:** Vivendi [illegible] Merrill Lynch & Co.

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BRITAIN

BEYOND BEER AND PEANUTS

Industry consolidation has brought better grub—and higher profits—to the pub

LONDON Lunch at the Wells, where food is now a draw

FOR YEARS, THE PUB AT THE corner of Pimlico Road and Ranelagh Grove in Southwest London was a dingy, dark watering hole serving little more than warm beer and peanuts. Thanks to a new tenant and a $1.3 million renovation, the Ebury now offers sleek seating, martinis, and posh fare such as wild halibut with king prawns and champagne-poached peaches. In its old life, the pub brought in $7,000 a week. Now it makes ten times that much. "The old boozer has been transformed," says Tom Etridge, who has run the pub since 2003.

The makeover is the latest sign of a major shift in the $36 billion pub industry. Most of Britain's 60,000 drinking establishments are now owned by big chains, thanks to a wave of consolidation that began five years ago. Enterprise Inns PLC, which owns the Ebury, boosted its holdings to nearly 9,000 pubs last year when it paid $4 billion for 4,000 taverns from Unique Pubs Ltd. These new owners are spending big money sprucing up their holdings and are changing the very definition of what a pub is in Britain. "Gone are the days when pubs were dominated by men drinking beer," says James Ainley, director at Dresdner Kleinwort Wasserstein in London. "Now pubs offer a much more attractive format for men and women, young and old."

A key part of the new format is food. This year, according to market researcher Mintel International Group Ltd. in London, food sales at pubs will soar to $11.52 billion, a 30% jump from 2000. Pubs still make most of their money from selling drinks. But serving food has become popular that more than 80% of pubs n do it, says the British Beer & Pub Assn. A the fare is more upscale. "A pint of dod old beer in a dirty glass just doesn't do i says Enterprise CEO Ted Tuppen.

The move toward higher-quality food fattening profits and boosting share pric Enterprise and another big chain, Pun Taverns PLC, both of which make mon by leasing out their refurbished pubs to dividual tenants and then selling th beer, had record results last year. Pret profit at Enterprise jumped 23% to $3 million on the back of a 48% jump in re enues, to $1.3 billion. Punch's profit r 38%, to $280 million, as sales rose 49%, $1.1 billion. Smaller concerns, li Mitchells & Butlers PLC and Greene Ki have had a good run, too. Even the rece economic slowdown hasn't hurt. "Wh the economy slows, people tend not to on holiday, but they will spend more small-ticket items like eating out," sa Charles Wilson, equity analyst at stoc broker Bridgewell Securities Ltd. in Lo don. In addition, analysts expect that t change in regulations allowing pubs stay open longer, effective November, w help profits at the margin.

A SMOKING GUN?

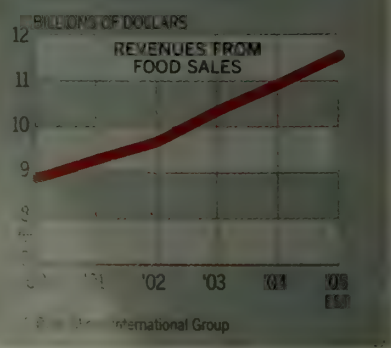
THAT'S WHY EFFORTS to upgrade ev the smaller taverns can pay off. Take t Landseer, a North London pub owned Punch. When restaurateur Tom Cro took over the lease nearly two years ago, oversaw an $80,000 remodeling a hired a new chef. Sales have risen by 30 a year, to about $16,200 a week this ye Similarly, a renovation at the Wells, a p in the upscale London neighborhood Hampstead, turned it from a musty bar a swanky establishment. "Now we go the pub for food—and it's quite goo says Hardie Peter, a retired British en neer who frequents the Wells.

Pub owners can't ford to be complace The government threatening to impo a smoking ban in pu that sell food by 200 But such a ban in I land had a minim impact on sales, so e ecutives say they are worried. Says Fran Patton, Punch's cu tomer services dire tor: "Boom or bu pubs go on." ■

–By Laura Cohn Lond

BANGERS AND MERLOT

British pubs are serving up more and better food



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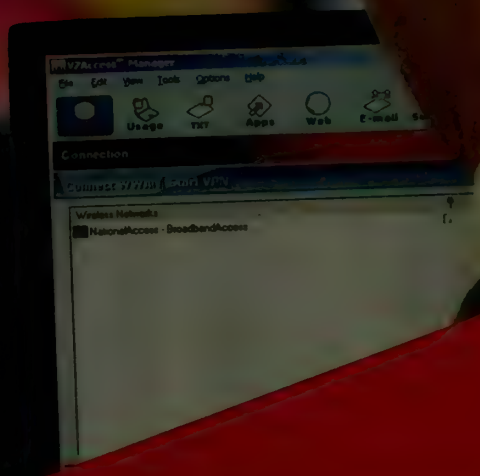

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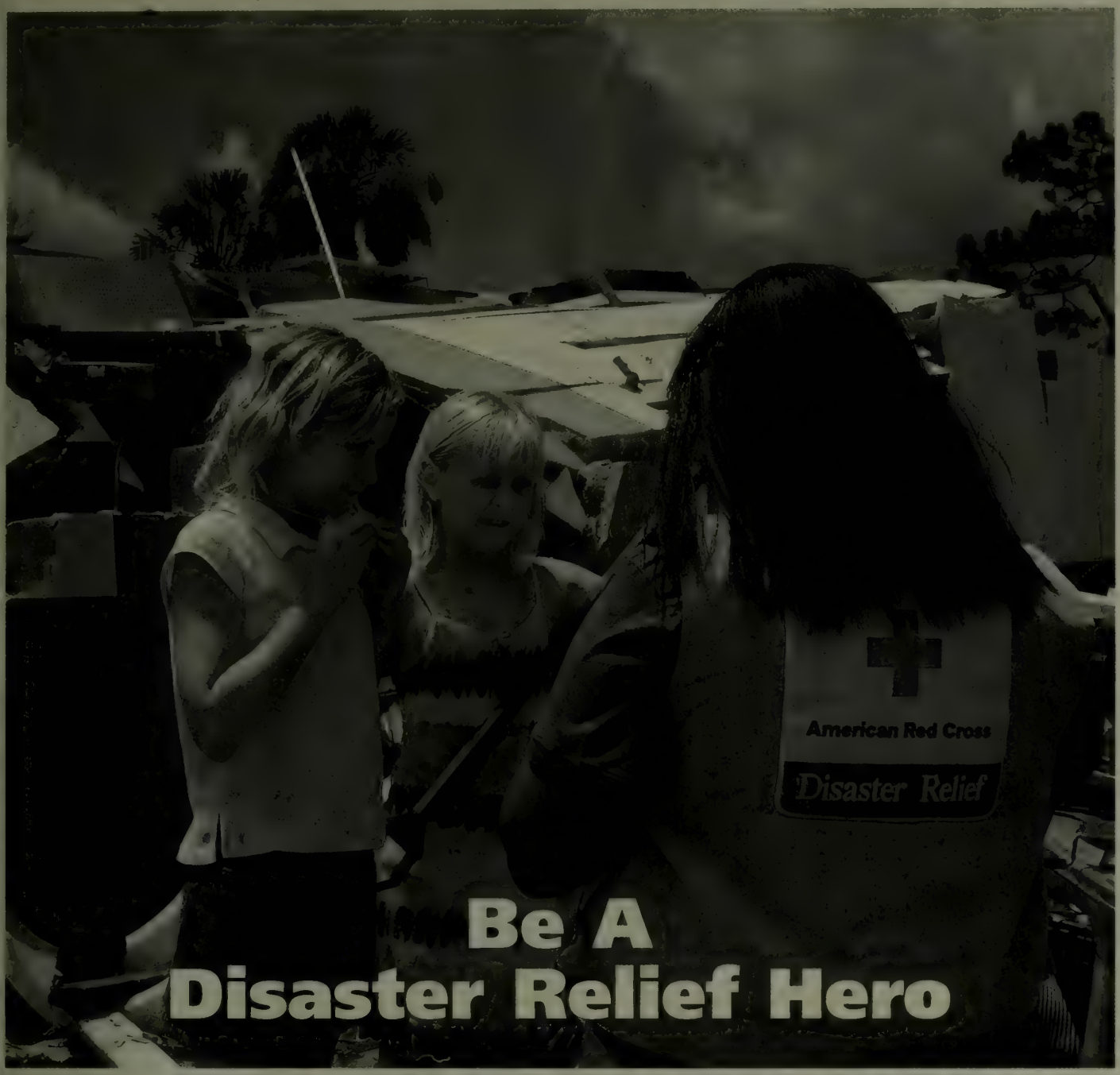

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BUSINESS AIRCRAFT: OWNERSHIP, SOURCING AND SOLUTIONS— HOW TO MOVE FROM CONCEPT TO REALITY

he digitally designed Dassault Falcon 7X business jet, which first flew in May, is expected to enter service in 2006. The new, three-ngine, long-range aircraft is unique among corporate airplanes in that it features fly-by-wire flight controls, which will enable it o fly more efficiently and handle even better than its predecessors.

Examining aircraft selection and ownership options is a key element within the overall process of acquiring private air transportation.

It's about time. You have heard Warren Buffet, Jack Welch and other business leaders talk about the benefits of business viation, especially the advantages of setting our own travel schedule and being able to ork undisturbed on the company aircraft.

You know travelers who have chosen usiness aircraft because too many hours have een consumed waiting for airline connec-ons. Too many trips that should have been nade were postponed because of scheduling onflicts. Too many of their competitors had ained an advantage because they used a busi-ess aircraft to reach their customers faster, thereby having the right person in the right place at the right time.

Perhaps you know people who have sufficient means to have their own jet or tur-boprop and who spend less of their leisure time traveling and more of life's precious resource with their family, and you want that mobility for yourself and those close to you.

You have done enough research to determine that your company can afford an aircraft and use it efficiently to increase the productivity of your key personnel. Or per-haps you have reached that stage in life where you can afford private air transportation. You are impressed with the excellent safety record of professionally flown business jets,

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A THREE-PHASE APPROACH

Leading Edge Aviation Solutions, LLC, the Dallas-based aviation consulting firm, has developed a methodology to help guide clients through the myriad steps needed to make sound, unbiased and informed decisions regarding aircraft acquisition.

According to Leading Edge CEO Barry Justice, this method works for all types of clients—from private individuals who participate in jet card or fractional ownership programs to multinational public corporations that operate a fleet of aircraft.

The three phases of aircraft acquisition are strategic planning, tactical implementation (execution of the strategic plan) **and operations** (operational start-up and transitional issues). Perhaps the most important phase is strategic planning, which begins by performing a "current-state assessment" and ends with a comprehensive plan that addresses all pertinent issues related to the acquisition of an aircraft.

- What are you doing now to satisfy air travel requirements—airline, charter, jet card, fractional aircraft, whole aircraft or a combination of the above? What in your present arrangement works and what doesn't? If you have a flight department, does it employ industry best practices and protocols?
- What are your annual travel requirements? What percentage of those trips are short, medium and long range? How many passengers are on each of those kinds of trips?
- Establish a baseline current-state financial model to compute sensitivities to key issues, including market values and appraisals of all assets, lease documents (cost to terminate), ownership entity structures and purpose, current costs and spend rate, forecast capital and operating budgets to continue with current assets based on miles flown.
- Perform a needs and wants assessment. First, understand the difference between a want and a need. Often, high-net-worth individuals don't have to justify cost or needs, while corporate governance generally requires documentation of business purpose and need justification.
- Establish a planning team to help define all elements of the needs and wants assessment. Involve the following people, as applicable: owner(s) and/or senior management, flight department management, aviation consultants, legal (internal and external), financial planners (CFO, internal and external analysts), capital appropriation planners, accountants, administrative services, banker, security, risk management, human resources, procurement and facilities management.
- Define needs around strategic plans, organizational and legal entities and governance and compliance requirements (i.e., what's going on in the business—organizationally, geographically and demographically). Travel to new destinations and frequencies of travel should be articulated. If organic growth, mergers, acquisitions or divestitures affect the business, define travel impact by destinations, frequencies and passenger demographics.
- In short, what do the owner(s) or senior management need to efficiently manage the business? Is there personal use? Is it documented and reported in compliance with regulatory requirements?
- Will the existing entity continue to own the assets (if aircraft are owned), or is a change contemplated?
- What type of operational constraints must be met regarding aircraft range and cabin size, capital outlay, operating budgets, headcount, facilities and locations? Are there specific types of aircraft that are, or are not, to be considered? Is there a preference for a new or a previously owned aircraft?
- Financially and operationally model (qualitative and quantitative) alternative solutions. Outline the process and define default assumptions of factors. Define a broad scope of aircraft that will meet requirements. Narrow the candidate aircraft based on constraints, needs, wants, and pros and cons of assets and original equipment manufacturers.
- Model the costs based on the following factors: Type of operation (FAR 91 private or FAR 135 commercial). Will there be income generated, and how will it affect depreciation schedules? Miles flown. Type and age of aircraft and projected maintenance (new in-warranty vs. previously owned and out-of-warranty). Aircraft-specific historical residuals and market trends. Consider all financial assumptions—cost of capital, default tax rate, appetite for depreciation and alternative minimum tax situations.
- Model output should provide initial capital to purchase, operating budget for asset period defined, pre-tax cash flow, after-tax cash flow, net present value under three assumptions—(1) keep the asset operational after the tax depreciation schedule is amortized, (2) trade the asset utilizing an IRS-qualified 1031 like-kind exchange, (3) sell the asset and pay the recapture on the gain at ordinary tax rates.
- Finally, review the financial and operational output of the analysis with management. Agree on a strategy and the next steps. Define roles and responsibilities of team members for implementation. ◆

which is on a par with that of the large scheduled airlines. You seek the security th comes from knowing who is on your aircra

Deciding that you or your compar would benefit from business aviation is th first step. What to do next may seem compl because many options exist and business av ation probably is not your area of expertis The purpose of this special section is to he you decide how to proceed.

A PROCESS APPROACH

Acquiring all or part of a business ai craft should be examined as a key element i a multi-step process of providing efficient a transportation. Procedures exist for arrivin at each decision, and they should be unde stood and applied in keeping with best pra

Make sure that the airplane is mechanically sound. Don't simply fall in love with the aesthetics (e.g., a beautiful interior).

tices of the aviation industry. For the proce to produce an optimal result, metrics for me suring the outcome need to be established an examined. Each step along the path must b identified with sufficient specificity so that th entire process of providing safe and efficie transportation can be repeated to achieve cor sistency, audited to ensure quality and mon itored to facilitate continuous improvemen

The need for a rigorous proce approach is more important now than eve before. Business aircraft fly higher and faste than their look-alike predecessors. They a equipped with advanced navigation an safety systems that provide a new dimensio of safety, making them among the bes equipped aircraft in operation today.

Government regulations also hav changed recently, most notably the rules go

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On a Higher Plane

Fractional aircraft provider Flexjet, a division of Bombardier, offers a variety of business jets built by its parent company, including the new Challenger 300.

erning fractional ownership and the operating requirements for flying in high-altitude airspace. In addition, two new federal laws—the Sarbanes-Oxley Act of 2002 and the American Jobs Creation Act of 2004—have changed reporting requirements and tax treatment of corporate-owned aircraft when flown for personal use or entertainment.

In addition to equipment and regulations, new ways for delivering business aviation travel have emerged and evolved, from fractional ownership and innovative aircraft management plans to prepaid charter cards that allow the purchase of a few flight hours on business aircraft for a flat fee.

Hire a qualified company (an FAA-designated repair station for the type of aircraft you are considering) to perform a pre-purchase inspection of a previously owned aircraft.

EXPERT ADVICE

Yes, it's a sophisticated world in which business aircraft operate, but those who are knowledgeable and experienced can navigate it. The transportation process begins by acknowledging that whatever you or your company knows about business aviation could be enhanced by tapping additional resources.

Barry Justice, CEO of Leading Edge Aviation Solutions LLC, a Dallas-based consulting company that has worked for more than a decade with hundreds of individuals and many S&P 100 corporations, as well as the top private banks and wealth-management firms, to provide business aviation solutions, said, "When you buy an airplane, you really ought to solve a travel problem in a systematic way and source a solution that meets you needs. One of the keys to doing it right," sai Justice, "is to assemble a team of aviatior financial, legal, risk management and othe experts—from both inside and outside you company. This is important because man people not involved in business aviation on daily basis 'don't know what they don't know An informed aircraft-acquisition decisio based on quality information is not tha expensive to attain, but a decision based o poor or incomplete information can cost mil lions."

IDENTIFYING NEEDS

The first step in the process is to identi fy what your travel needs are, and th industry-leading suppliers are adept at help ing with such studies.

Bryan Moss, president of Gulfstrean Aerospace Corporation, which makes a lin of business jets, said, "We begin our dialogu with customers with a series of discussions, th purpose being to determine what is mos important to them. We probe to clearly iden tify what role an aircraft will play in thei company or their personal life. What will b the mission of the aircraft? Are travel need simply domestic, or does the client intend t fly internationally? How many people ar likely to be traveling at any one time Where will the aircraft be based, and wha facilities are available there? How much doe

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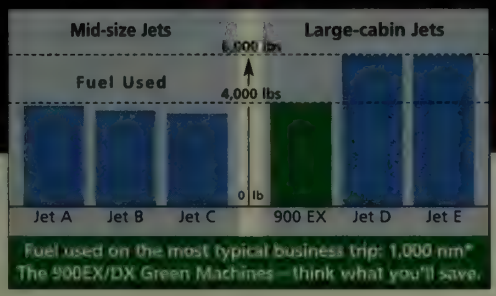

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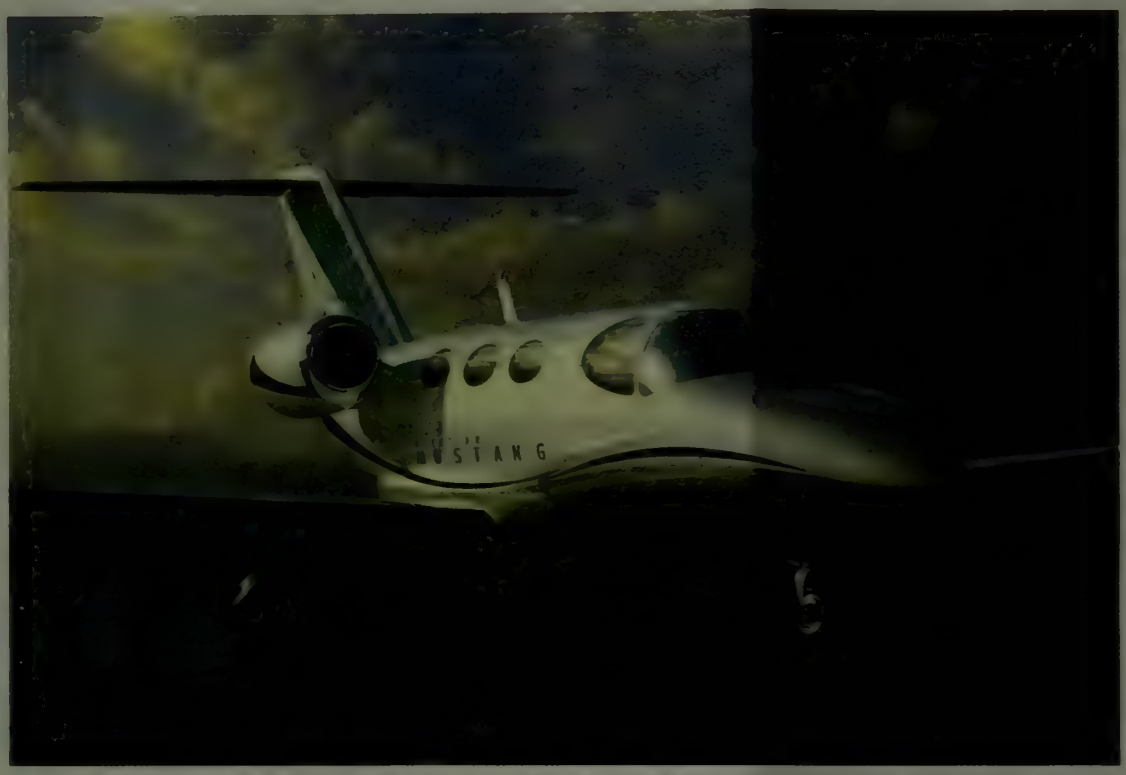

Cessna's Citation Mustang is one of the new generation of very light jets that promises to make private jet travel even more affordable. The six-seat aircraft, which first flew in April, is expected to enter service in about a year.

the client expect to use an aircraft each year? We seek to fully understand the client's travel expectations, as well as additional objectives—such as sources and uses of funds, depreciation and other tax considerations—before proposing a Gulfstream to meet their needs."

Because business aviation is a specialized form of transportation involving many sophisticated decisions and technologies, those who decide to buy their own aircraft often turn to aircraft management companies such as TAG USA for expertise.

"Our job is to find out what a company or individual needs and provide it," commented Gil Wolin, VP of corporate communications for TAG Aviation USA, Inc., which manages a fleet of 130 aircraft at 55 locations. "TAG provides services, such as crews and scheduling, as well as expert advice for the company or individual at each step within the process of providing private air transportation. We also are able to use our clients' aircraft within our charter fleet [illegible] owner wishes to make the aircraft avail[illegible] for such revenue-producing activity."

In recent years, many people have been introduced to business aviation through fractional ownership programs, which allow companies and individuals to own a share of a business aircraft without the associated obligations, and at a fraction of the cost, of running their own flight department.

Flight Options focuses first on customer needs before offering solutions. Cameron Gowans, chief marketing officer for the Cleveland-based provider of fractional ownership, charter cards and all-inclusive leases of business aircraft, said, "We begin discussions with potential customers by asking three questions: What is their mission need? Are they financially capable of using private air travel? And finally, does the client truly desire this form of travel? Business aviation provides great value, but on the surface it is not the cheapest way to travel. The buyer must accept the premise that the overall value of time saved and time used productively more than balances the cost of this form of travel."

Because travelers' needs are diverse, another major fractional aircraft provider, [illegible]et, a division of Bombardier Aerospace, [illegible]s customers a variety of lift options, from chartering, to purchasing flight time in 25-[illegible]ks, to buying a share of one of the business jets built by the parent company.

Michael McQuay, president [illegible] Bombardier Aircraft Servic[illegible] said, "Flexjet is distinctive [illegible] its focus on service excellen[illegible] and continuous program in[illegible]vations that provide uniq[illegible] benefits to owners, such as [illegible] waiver of ferry fees to [illegible] Caribbean and other isla[illegible] destinations."

KEY DECISION POINT[illegible]

With the start and e[illegible] points of the transportati[illegible] process defined, the next st[illegible] is to identify the decisio[illegible] that lead to achieving safe a[illegible] efficient travel. Promine[illegible] among them is decidi[illegible] which aircraft, business avi[illegible]tion option or blended soluti[illegible] of aircraft, fractional sh[illegible] and/or charter card best su[illegible]ports the desired results.

Get your insurance company or risk manager involved in the aircraft acquisition process early. Otherwise, you could find yourself operating with inadequate coverage or an unacceptable level of risk exposure.

"I agree that looking at the acquisition [illegible] an aircraft as an element within the process [illegible] providing transportation is a reasonab[illegible] approach," observed Jeff Habib, Dassault F[illegible]con Jet Vice President for Western U.S. Sal[illegible] "But I caution that every deal is different, a[illegible] not all clients follow a structured approach [illegible] business aviation, even if they should."

"At Dassault Falcon Jet, we start the d[illegible]logue with prospects by identifying seve[illegible]

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Advanced cockpit technologies incorporated into Dassault's EASy flight deck (left) are designed to make piloting new business jet more intuitive. The 13-passenger Embraer Legacy (right) is the largest and newest aircraft offered by fractional provider Flight Options

Examine the tax consequences of your aircraft purchase. Failing to plan properly could cost you dearly in the long run.

issues, including what are their budget considerations," continued Habib. "Then we move into a full discussion of the client's transportation requirements, such as typical missions, range and runway performance, cabin volume, passenger load, baggage space, tax considerations and anticipated years of service for the aircraft. It is important that clients consider the residual value of an aircraft when defining what they want from their business aviation experience.

"We [also] introduce independent third-party information on hourly and life-cycle costs from respected sources," added Habib. "Our sales engineers use established financial tools and computer programs to do comparisons, as do our competitors. It is not unusual to have clients hire the services of independent experts to assist in their evaluation of business aviation options. Business aviation involves significant capital expenditures and ongoing costs of implementation. There is a risk that the buyer may move too quickly. It is essential that those considering the purchase of an aircraft be mission-focused."

HOW TO PAY

The process of achieving satisfactory transportation solutions involves more than just deciding which aircraft to purchase or which fractional ownership program or charter card is best. Using business aviation involves a significant commitment of capital, so the financial tools used to acquire an aircraft or fractional share require careful consideration. Should assets be purchased outright or financed? What about leasing? What is the best way to depreciate these assets? And when is it best to replace a business aircraft that has been depreciated rapidly?

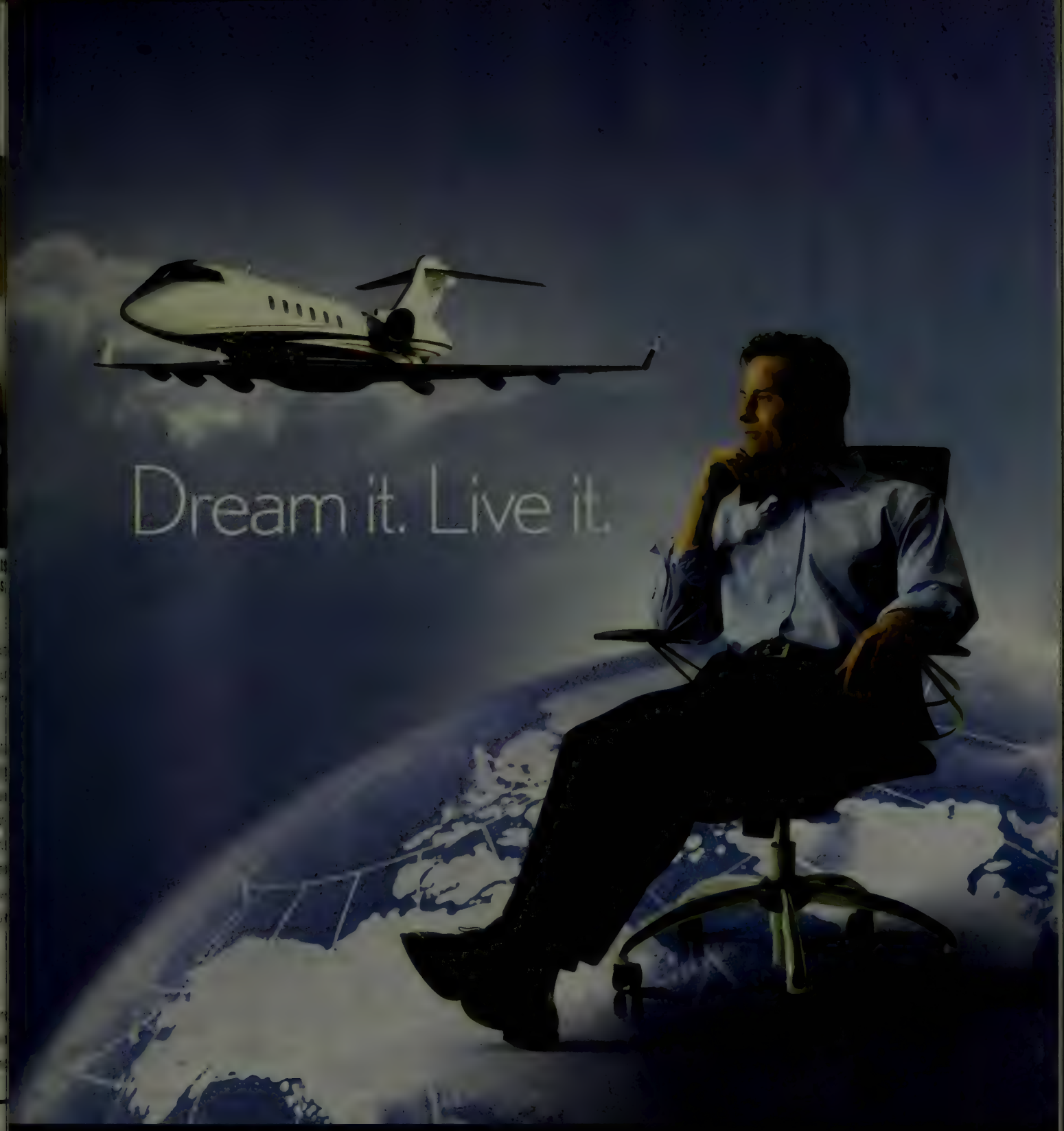
"Financial considerations are woven into many elements of the transportation process," said Jim Dickerson, head of Bank of America's Aircraft Financing Division. "They start with selection of an aircraft, the structure of ownership and the method of operation," he continued. "Will the client select the right asset, and if it is a pre-owned aircraft, was there a good pre-buy inspection to ensure it was fairly valued? Will a C corporation own the aircraft, or will the owner use an S corporate structure? Does the owner [illegible] the aircraft available to an air taxi company that will offer it for charter, thereby generating income for the owner when not being flown for company or personal use?

"How a company or individual plans to use an aircraft is fundamental, particularly in light of the tax implications of the American Jobs Creation Act of 2004. What about the aircraft's residual value and the tax consequences of a fully depreciated asset? What about the cost of money, which is always a consideration? It is vital to address financial and tax issues early in the process."

PROCESS OVERVIEW

Establishing the operating parameters for achieving safe and efficient transportation also involves hiring personnel to manage the

Spend the money to hire the best available aviation staff. They are there to protect you and your assets by providing the highest possible level of safety and professionalism.



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Gulfstream Aerospace, renowned for long-range jets such as this G550, now offers mid-size models as well. New features include advanced equipment such as enhanced vision systems.

transportation process, establishing reporting procedures that align the transportation function with overall company objectives, finding pilots, selecting suitable sources of maintenance, constructing a system for scheduling flights, determining how the aircraft will be allocated between users, setting safety-oversight and risk-management functions, developing and implementing security procedures, and selecting a training organization to satisfy safety requirements.

Each step within the transportation process should be documented to ensure that personnel responsible for specific functions know what they are expected to accomplish and how to achieve it. Measures of success—such as travel hours saved by using business aviation, rather than airlines, improved client relations, new customers reached, cost per passenger mile or other metrics—should be established and systematically reviewed to determine the degree of success you are achieving in satisfying your travel objectives. The entire process of providing transportation via business aircraft should be audited to ensure compliance and to identify areas for improvement.

Understand that your business acumen will not necessarily make you an expert in aircraft procurement. Seek the counsel of others who are intimately familiar with the technical details and current market conditions.

You know you can benefit from using private aircraft. Now you just need to examine carefully all the options to determine which solution is best for you. ◆

TWO VITAL RESOURCES

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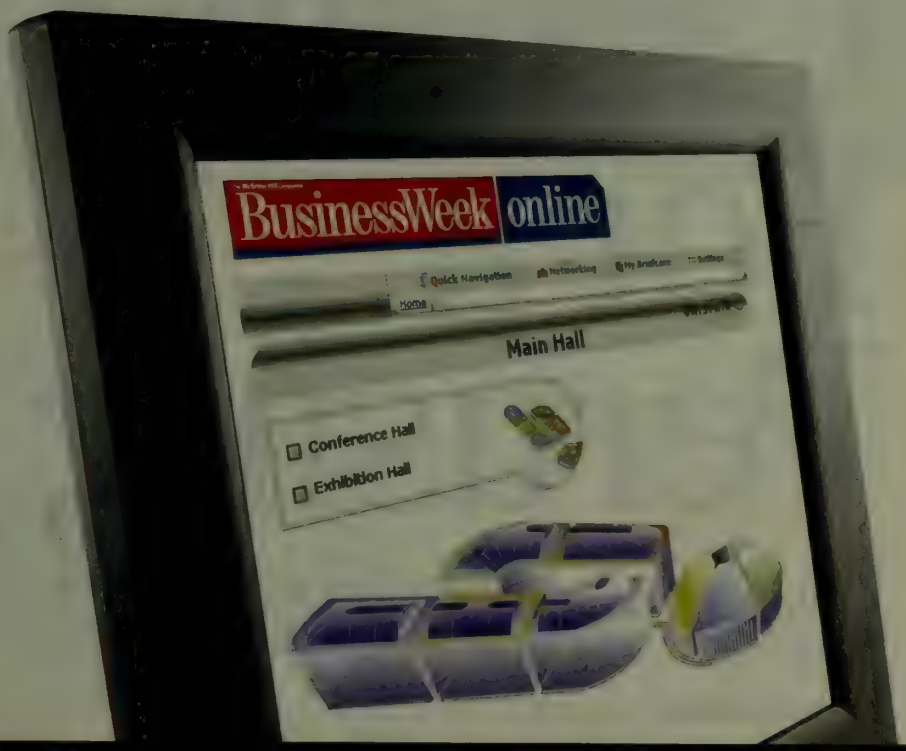

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EDUCATIONAL GETAWAYS

Cruising For a Perusing

Prefer learning to lounging? Try a voyage with academic appeal **BY SUSAN GARLAND**

IN MAY, PATRIC
Geismar, her hu
band, Richard, a
some two doz
friends boarded t
M.S. Kazan,
deluxe riverbo
with 75 cabins, fo
10-day cruise alo
a chain of Russi
rivers and lakes from St. Petersburg
Moscow. A highlight of the trip was Kiz
one of more than 1,300 islands on La
Onega. There they visited the 18th centu
Church of the Transfiguration, whose
domes were built without a single nail.

A Russian guide was by their side
the way. She spoke with the group abo
the history, politics, and economy of t
country during lectures and al
schmoozed with them during inform
conversations in the library and by t
pool. "Her skills and knowledge rea
brought everything alive," says Geism
of Greenwich, Conn.

Cruising doesn't have to be about lim
on the Lido deck. Like the Geismars, y

n embark on an intensive learning expe-ence on one of the small-ship cruises of-red by alumni associations, cultural or-nizations, and museums. The Geismars oked their trip through High Country ssage, a San Francisco firm that designs urs for nonprofits but also takes direct servations (hcptravel.com). The Ameri-n Museum of Natural History is sched-ing a similar Russian river trip next June, r $8,045 to $9,450 per person.

Travelers can choose from among a ide range of domestic and overseas uises that cater to a variety of interests. pically the organization will create a stomized itinerary based on the experi-ce of the expert who will lead the tour.

OMERIC VOYAGE

OMEONE INTERESTED in the Ante-llum South can travel on the Atlantic In-coastal Waterway in November with storians from the National Trust for His-ric Preservation. If your tastes run more ward unusual fish, plant, and bird ecies, you can join a curator of marine e on a trip to the Indian Ocean in March. he National Geographic Society has set veral 15-day winter expeditions, led by a lar explorer, to visit icebergs, volcanoes, hales, and penguins in Antarctica.

Although knowledge-hungry cruisers e usually in their 60s or 70s, travel ex-rts believe that older and wealthier baby omers will turn to such trips. "Many unger travelers like rigorous academic periences in which each destination is ilt into the theme," says Philip Lovejoy, sociate director of alumni education at e Harvard Alumni Assn. One such cruise, Retracing the Life of Homer," designed a professor of classical Greek literature, ill tour key places in Homer's life and lit-ature in Greece and Turkey in June.

For those who want to leave Homer at me and take the kids instead, many oups do provide family cruise fare. In te December and again in February, a ecialist from the Smithsonian Institu-on's National Zoological Park will lead a mily riverboat voyage down the Amazon. ids, who must be over 8, will be able to noe, fish for piranha, learn jungle sur-val skills, and identify medicinal plants.

If you're seeking the big-ship experi-nce with casinos and Las Vegas-style tertainment, these cruises aren't for u. Most vessels—they include yachts, verboats, and steamboats—can sleep 30 150 passengers. The smaller vessels, ough, can sail on rivers and dock at ports that can't accommodate the giants.

Smaller ships can also take advantage of the unexpected. The RV Mekong Pandaw, a replica of a colonial-era river steamer, has a shallow hull that enables it to visit remote locations. Last fall, Dorothy and Kirke Comstock of Portola Valley, Calif., took the vessel up the Mekong River in Cambodia with three professors on a High Country Passage trip. Dorothy recalls that, as they were passing a small village, a group of saffron-robed Buddhist monks, children, and town elders invited the 50 or so passengers to make an unscheduled stop. There was no dock, so they walked off the boat on planks. "The monks took us on a 35-minute walk to see their very old temple," she says. "It was unforgettable."

Such experiences come at a price. A 20-day Harvard trip in February on a 106-passenger ship to New Zealand, Australia, and Tasmania will cost $9,995 to $11,895 per person, not including airfare. But these trips are first-class all the way, says James O'Reilly of Houston. O'Reilly and his wife, Lydia Hilliard, have taken two cruises on the Sea Cloud II with the National Trust: one to gardens in Ireland and another to Normandy on the 60th anniversary of the invasion. O'Reilly says his room, which was cleaned several times a day, even had an electric fireplace. And the food, he adds, was "sumptuous."

To find a cruise, check the Web sites of major museums, cultural organizations, and operators that specialize in academic-focused tours. If your alumni group does not offer a cruise that appeals, look at other universities. Many alumni organizations open cruises to nonmembers. Before signing on, ask for a full itinerary and about the the study leader's background.

In some cases, two or more organizations travel together to fill a ship. In April, Dr. Terry Howard and his wife Phyllis of Chelmsford, Mass., took a 64-cabin cruise ship, the *Clipper Odyssey*, on an arts tour, visiting museums and shrines around southern Japan with the American Museum of Natural History. Groups from Harvard and Yale were aboard, so passengers could take advantage of several study leaders, all experts in Asian art. Three local Japanese guides also were present, he says, "so we could pump them about society and politics."

DOME AWAY FROM HOME The Church of the Transfiguration on Kizhi Island

On one collaborative trip (Harvard and Princeton are among the co-sponsors), Mikhail Gorbachev, Lech Walesa, former Defense Secretary William Perry, and other former world leaders will spend at least part of a 12-day cruise in the Baltic Sea with 180 travelers next June. Presentations will focus on the evolution of the region from the Cold War to the dissolution of the Soviet Union. It costs nearly $10,000, but sitting poolside with people who changed the world could be considered priceless. ■

BusinessWeek online For more on educational cruising, go to businessweek.com/extras

BANGKOK Start with a guided tour through a Thai market

THAILAND

The Lure of Lemongrass

There's a Thai cooking class for every budget—from $15 up to luxury all the way. **BY FREDERIK BALFOUR**

THE DAY AT BANGKOK'S Blue Elephant Cooking School began with an 8:30 a.m. visit to the Bang Rak morning market. Stalls were heaped with exotic tropical fruits: spiky rambutans, purple-skinned mangosteens, and bright red lychees. We also found a vast array of herbs and spices essential to Thai cuisine: galangal, coriander root, kaffir limes, lemongrass, tamarind, shrimp paste, freshly grated coconut, pandam leaves, three types of basil, and, of course, chilies of every size.

I couldn't think of a better way to awaken my inner chef and psych myself up for an intensive crash course in Thai cooking. Even if you don't plan to cook the dishes at home, the cooking school experience gives you insight into life in the country you're visiting. Thailand happens to be known for its many culinary schools catering to every budget. In Bangkok, where the central Thai approach to cuisine uses coconut milk and cream to take the edge off of chilies in curry dishes, you can sign up for the four-hour Blue Elephant course for $70. Or you can buy a five-night package at the Oriental Bangkok for $1,600 per person, including room, four half-day cooking sessions, breakfasts, and a one-hour massage.

If you're traveling to the north, where dishes are broth-based and tend to be more fiery, the city c Chiang Mai boast dozens of schools There you can pa $15 for a full-da course in the heart of the backpacker dis trict or almost $1,500 per person at th Four Seasons Resort for a three-night sta with breakfasts and two four-hour cookin sessions. The Four Seasons kitchens fea ture teak worktables and overlook land scaped gardens and mountains. Classe begin at 7 a.m. and include a trip to th market, a traditional Thai spirit hous blessing, instruction on making four dish es that are then eaten at lunch, and a les son in the art of vegetable carving.

Back at the Blue Elephant, our instruc tor, Nooror Somany-Steppé, the school' founder, made everything seem easy. Bu when the five of us started to do the mea preparation ourselves for the tom klon seafood, I had a scary flashback to hig school chemistry class, where I always fel hopelessly behind during experiments.

EAGER ASSISTANCE

I QUICKLY OVERCAME my performanc anxiety as I began smashing chilies an coriander roots with my mortar and pes tle and grilling galangal, lemongrass, an shallots in my wok. Then I threw the lo into hot seafood stock, followed a minut later by shelled prawns, squid, fish fille scallops, mussels, and white mushroom Fish sauce and tamarind juice gave th broth extra zest, and my mouth was wa tering by the time it all came to a boil. Bu before I got a chance to savor my creation it was whisked away and labeled with m name for tasting at lunch.

Our second dish was po-pia thot, o deep-fried Thai spring rolls. Making th filling was easy because nearly all the in gredients, such as carrots, cabbage, blac mushrooms, and crabmeat, had bee carefully laid out for us in advance. Eri Millman, a professor of psychiatry at Yal University working next to me, rolled u the wrapper with the deftness of a Ha vana cigar maker. I was all thumbs. Sens ing my distress, the assistant assigned t

MAKING SOUFFLES Blue Elephant's four-hour class costs $70

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me intervened, helping me at the crucial moment when you dab a bit of egg yolk to help seal the pastry roll. So eager was he to help that he would have finished the whole batch for me had I not gently elbowed him out of the way.

The third dish, homok kai, or Thai chicken soufflé, was well worth the struggle. Normally the ingredients are steamed inside cups fashioned from banana leaves, but we used glass ones to save time. For this savory dish you mince chicken with kaffir lime rind, garlic, coriander root, galangal, curry paste, and coconut milk. Then you pour this mixture over cups lined with basil leaves and a thin slice of raw chicken. Top with sliced red chilies and coconut cream.

I felt shortchanged in the preparation of the final dish, ped makarm (duck with tamarind sauce). In the interest of time, we worked with duck that had been marinated, cooked, and sliced in advance, leaving the task of mixing five ingredients for the sauce and garnishing the m

Finally, we sat down in the Blue l phant's magnificent dining room, with filigreed arches and 16-foot ceilings. B as a trading house in 1903, it is one of few colonial-style buildings left Bangkok. We washed down the meal w Blue Elephant's own Thai white wine, lowed by cheesecake made with a crea but pungent Southeast Asian fruit cal durian, compliments of the chef. Not b for four hours of work. ■

SANTA FE

Cooking School: Don't Get Burned

Head off disappointment by asking the right questions before you go. BY JOYCE BARNATHAN

LAST YEAR MY HUSBAND and I visited Santa Fe, where we experienced our first taste of authentic Southwest cuisine. Who knew there were so many New Mexican chilies and local spices? Delighted by the bold flavors, we bought a cookbook from the Santa Fe School of Cooking; the guacamole recipe was superb. So this year, when we decided to vacation in Santa Fe again, my son and I signed up for a class at the school for $70 each.

Let's just say the class was not as satisfying as the meal. Don't get me wrong: Our chef, Rocky Durham, was very knowledgeable, and the food—featuring a low-carb Southwestern lamb dish—was delicious. But before you attend any cooking course, some words of caution:

» Check whether you'll actually be doing the cooking. We discovered when we got there that this was a demonstration class, not a hands-on lesson. When we signed up online, the Web site made no mention of this. As expert as Durham was at making Rack of Lamb Adovada (marinated in red chilies) and Grilled Eggplant Enchiladas with green chili pesto, among other dishes, we wanted the experience of preparing the meal ourselves. The site did say that some classes were demonstrations and some were hands-on, but it didn't specify which were which. When told about this, cooking school owner Susan Curtis said she would make the Web site clearer. Still, she advised, "it's a good idea to call."

DEMONSTRATION ONLY Web sites can be vague about specifics

» Beware of marketing pitches. In a lighthearted way, our chef confessed that he was asked to "push sales" of the school's products—and throughout the 2½ hours he reminded us how we could purch everything from a stove-top roasting g to whole spices at the adjacent store. I spect that the school holds local goods high regard. But the hard sell was a much and made us question whether school existed primarily to bolster st sales. Curtis' response: The school l nine chefs, and each presents the course his or her own way.

» Find a menu you can replicate at hor Our fare was too complicated for even chef to prepare in the given time. A seasoning the lamb, making the gr chile pesto and red chili sauce, and m ing the red chili hummus, we ran out time to assemble dessert. Sor how, the fresh fruit with van crème fraiche miraculously peared as we finished eating main course.

» Make sure the kitchen is prop ly equipped. For a final flouri the lamb was seared in a ca iron pan to blacken it. Open the window to the balcony well as the door leading into building, the chef warned t the chili could let off an ac smell. It sure did. The th women at the table closest to stove inhaled smoke and star coughing until they had to s outside for air. A less-than-ap tizing moment. Curtis admit the vent in the room is "not r adequate." But she says the hood of overhead vent would block studer view of the chef, making it necessary use TV monitors.

I did learn a few things: Use wh spices, and grind them for maximum vor. How a chef seasons with salt se rates good cooks from great ones. Blacl a chili to make it easier to peel. Don't f you have to stick to a recipe—somethir can relate to since I can never replicat meal. Finally, find a cooking class that l you cook—and breathe—easily. ■

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VERMONT

This Way to the Curds and Whey

A cheese lover's tour yields samples, classes, and only-at-the-farm finds. **BY JANE BLACK**

"HELLO?" WE CALL as we step out of the car at the end of the long dirt road at Peaked Mountain Farm in Townshend, Vt. It's 3 p.m.—milking time—and Bob Works is heading to the barn to round up his 80 sheep grazing in a nearby pasture. My sister and I, both cheese aficionados, walk past the llama and two mini-donkeys that guard the flock, then watch the sheep parade inside, where Works's wife, Ann, hooks up eight at a time to the milking machines.

While we stand there, Bob sets up a tasting where we sample (and later buy) the farm's three cheeses: Vermont Dandy, a smooth 100% sheep's-milk cheese; Ewe-Jersey, half sheep's milk and half cow's milk; and a Bulgarian-style feta available only at the farm. "People think making cheese is romantic, but you should see us kicking up manure," says Ann. "The romance is in the eating" the cheese.

You can decide for yourself on a tour through Vermont's cheese country. Some 30 makers turning out traditional cheddars, nutty Alpine-style cheeses, and maple-smoked Goudas dot the map between Brattleboro and Burlington. Artisinal cheesemaking took off in the Green Mountain State about six years ago. Some makers arrived after successful city careers. (The Works left New York after the 1999 initial public offering of real estate firm Jones Lang LaSalle, where Bob was managing director.) Others are longtime dairy farmers who see gourmet cheese—and cheesemaking classes—as a way to help make ends meet. Either way, most open their farms for tours by appointment or, as at Peaked Mountain, by chance.

AN AFTERNOON, OR TWO OR THREE

TRUE CHEESEHEADS can sign up for a weekend cheesemaking course. One of the best is run by Jon Wright of picturesque Taylor Farm in Londonderry, known for its traditional and flavored Goudas. Every month through summer and fall, Wright, along with Mark and Gari Fischer of neighboring Woodcock Farm, invite a dozen guests for pasture walks and lessons on how to care for farm animals and make cheese (taylorfarmvermont.com).

FOUNDED IN 1890 Grafto is known fo its cheddar

Wearing hair nets and plastic bootie students troop into the cheese roo where they learn about rennet, the coag ulant that separates the curds and whe Next they help cut the curds into sma pieces, which makes it easier to extra moisture, then they move the curds int molds to be pressed into cheese. At di ner at a nearby inn, guests taste loc foods and learn to pair wine and bee with cheeses.

Cheddar lovers can sign up for a sim lar class at Shelburne Farms, an educa tion center and working farm on Lak Champlain, about 10 miles south Burlington. The three-day course, offere in September and again next spring, en gages you in the entire process—fro managing a herd of Brown Swiss cows t "cheddaring"—in which curd slabs ar stacked and restacked to encourage ba teria growth and extract moisture. Si months later you receive a block of ched dar that you made. The course is $45 per person, with meals. Rooms are $11 to $380 a night (802 985-8498).

Or you can simply hop from farm t farm, watching and tasting as you g Back in southern Vermont is the Grafto Village Cheese Co., founded in 1890 an producing cheddar since the 1960s. O head about 50 miles north, to Woodstoc Water Buffalo. The farm—the only wate buffalo creamery in the U.S.—milks 18 head a day to produce fresh mozzarell and yogurt, both of which are far riche than their cow's-milk counterparts. On taste here—or at any of Vermont' dairies—is guaranteed to spur your ro mance with cheese. ■

REAL DEAL Woodstock Water Buffalo mozzarella

We want you to know

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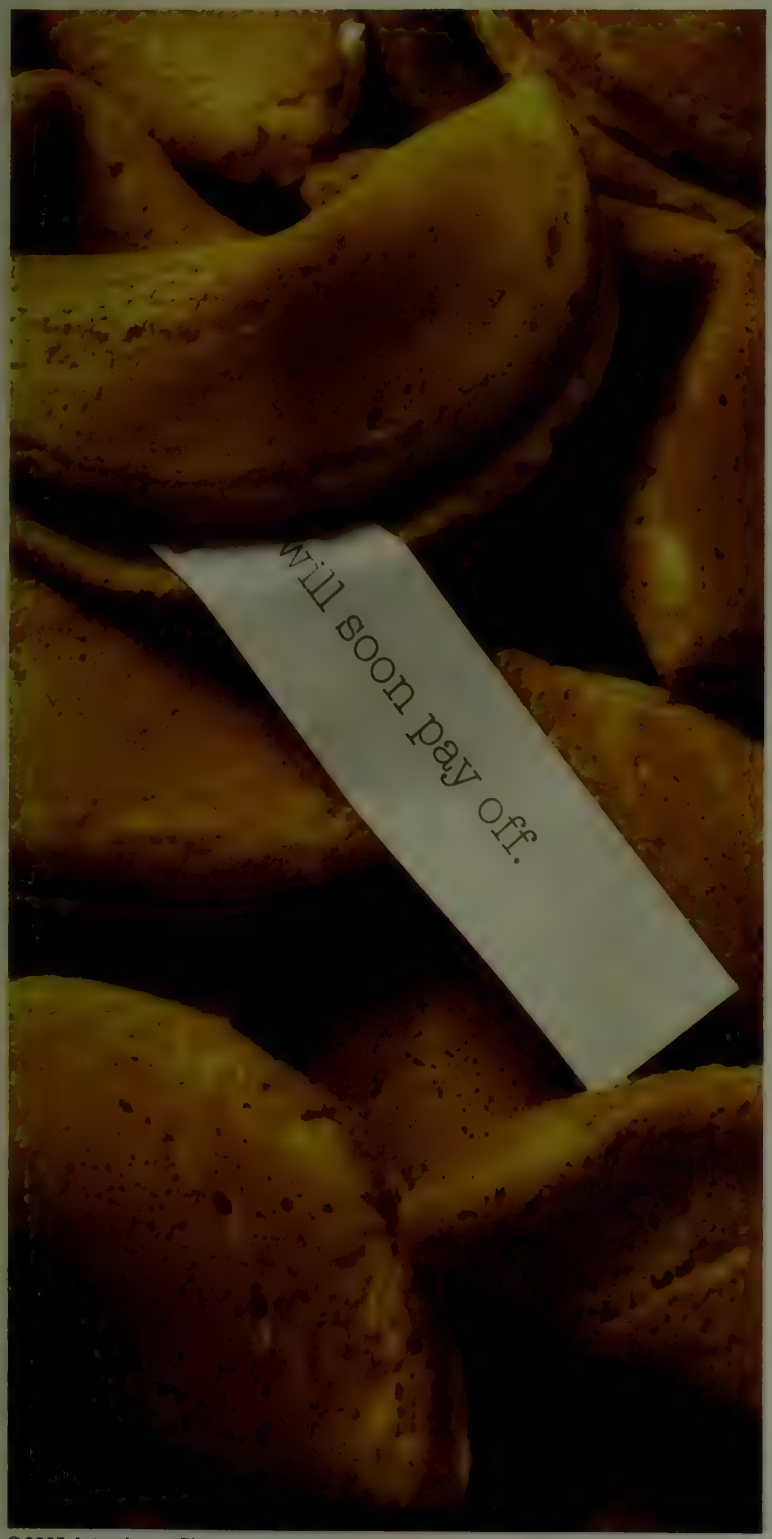

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ANTIGUA, GUATEMALA The Mayan ruins of Tikal are a coupl of hours away

GUATEMALA

Schools With a View

There are so many ways to study a language abroad that once may not be enough. **BY SUZANNE WOOLLEY**

IT WAS HOT, IT WAS RAINING, and the mud made a difficult climb up a steep, rocky trail that much harder. Rambo wanted to give up. I refused. And when we emerged from the tangled woods to see the Pacaya volcano erupt, we agreed the effort was well worth it. At least I think we agreed. He simply let out a snort before munching on some weeds.

I'd met Rambo a half-hour earlier, when three seemingly heaven-sent words reached this New Yorker's ears: "Taxi to Pacaya?" The question came from a Guatemalan girl atop a horse. *"Cuanto cuesta?"* I asked. *"Cuarenta quetzals* [about $5]." *"Excelente,"* I replied, and took her place on the horse. I'm no cowgirl, but I was studying Spanish in Guatemala and was lagging behind my fellow students as they tromped up the trail on this school-sponsored Saturday hiking excursion. I wasn't feeling well, and Rambo was a four-footed savior.

My motivation for going to language school abroad was one many travelers share: the desire to explore new countries and have interactions with locals that go beyond, well, good old "*Cuanto cuesta?*" I'd studied Spanish f years but struggled with speaking Learning in Central America while sta ing with a local family seemed a good w to break through the impasse.

Where to study was an easy decisi for me. A friend and I wanted to explo Tikal, the Mayan ruins in northe Guatemala. Its steep-stepped templ rise out of a jungle filled with howl monkeys, parrots, and, supposed jaguars. They're just a few hours away plane from the colonial city of Antigu which has language schools around eve cobbled street corner.

DO-IT-YOURSELFERS

WE USED A less-than-scientific approa to picking a school. Swamped with info mation from the Web, we went to a boo store and looked through all t Guatemala guides we could find and co tacted the schools mentioned most ofte The first to reply to my e-mail was AP (appeschool.com), so we paid our $

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Important Safety Information: Be sure you have at least eight hours to devote to sleep before becoming active. Until you know how you'll react to Lunesta, you should not drive or operate machinery. Do not use alcohol while taking Lunesta. All sleep medicines carry some risk of dependency. Side effects may include unpleasant taste, headache, drowsiness and dizziness. *See important patient information on the next page.*

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Please read this summary of information about LUNESTA before you talk to your doctor or start using LUNESTA. It is not meant to take the place of your doctor's instructions. If you have any questions about LUNESTA tablets, be sure to ask your doctor or pharmacist.

LUNESTA is used to treat different types of sleep problems, such as difficulty in falling asleep, difficulty in maintaining sleep during the night, and waking up too early in the morning. Most people with insomnia have more than one of these problems. You should take LUNESTA immediately before going to bed because of the risk of falling.

LUNESTA belongs to a group of medicines known as "hypnotics" or, simply, sleep medicines. There are many different sleep medicines available to help people sleep better. Insomnia is often transient and intermittent. It usually requires treatment for only a short time, usually 7 to 10 days up to 2 weeks. If your insomnia does not improve after 7 to 10 days of treatment, see your doctor, because it may be a sign of an underlying condition. Some people have chronic sleep problems that may require more prolonged use of sleep medicine. However, you should not use these medicines for long periods without talking with your doctor about the risks and benefits of prolonged use.

Side Effects

All medicines have side effects. The most common side effects of sleep medicines are:

- Drowsiness
- Dizziness
- Lightheadedness
- Difficulty with coordination

Sleep medicines can make you sleepy during the day. How drowsy you feel depends upon how your body reacts to the medicine, which sleep medicine you are taking, and how large a dose your doctor has prescribed. Daytime drowsiness is best avoided by taking the lowest dose possible that will still help you sleep at night. Your doctor will work with you to find the dose of LUNESTA that is best for you. Some people taking LUNESTA have reported next-day sleepiness.

To manage these side effects while you are taking this medicine:

- When you first start taking LUNESTA or any other sleep medicine, until you know whether the medicine will still have some effect on you the next day, use extreme care while doing anything that requires complete alertness, such as driving a car, operating machinery, or piloting an aircraft.
- Do not drink alcohol when you are taking LUNESTA or any sleep medicine. Alcohol can increase the side effects of LUNESTA or any other sleep medicine.
- Do not take any other medicines without asking your doctor first. This includes medicines you can buy without a prescription. Some medicines can cause drowsiness and are best avoided while taking LUNESTA.
- Always take the exact dose of LUNESTA prescribed by your doctor. Never change your dose without talking to your doctor first.

Special Concerns

There are some special problems that may occur while taking sleep medicines.

Memory Problems

Sleep medicines may cause a special type of memory loss or "amnesia." When this occurs, a person may not remember what has happened for several hours after taking the medicine. This is usually not a problem since most people fall asleep after taking the medicine. Memory loss can be a problem however, when sleep medicines are taken while traveling, such as during an airplane flight and the person wakes up before the effect of the medicine is gone. This has been called "traveler's amnesia." Memory problems have been reported rarely by patients taking LUNESTA in clinical studies. In most cases, memory problems can be avoided if you take LUNESTA only when you are able to get a full night of sleep before you need to be active again. Be sure to talk to your doctor if you think you are having memory problems.

Tolerance

When sleep medicines are used every night for more than a few weeks, they may lose their effectiveness in helping you sleep. This is known as "tolerance." Development of tolerance to LUNESTA was not observed in a clinical study of 6 months' duration. Insomnia is often transient and intermittent, and prolonged use of sleep medicines is generally not necessary. Some people, though, have chronic sleep problems that may require more prolonged use of sleep medicine. If your sleep problems continue, consult your doctor, who will determine whether other measures are needed to overcome your sleep problems.

Dependence

Sleep medicines can cause dependence in some people, especially when these medicines are used regularly for longer than a few weeks or at high doses. Dependence is the need to continue taking a medicine because stopping it is unpleasant.

When people develop dependence, stopping the medicine suddenly may cause unpleasant symptoms (see *Withdrawal* below). They may find they have to keep taking the medicine either at the prescribed dose or at increasing doses just to avoid withdrawal symptoms.

All people taking sleep medicines have some risk of becoming dependent on the medicine. However, people who have been dependent on alcohol or other drugs in the past may have a higher chance of becoming addicted to sleep medicines. This possibility must be considered before using these medicines for more than a few weeks. If you have been addicted to alcohol or drugs in the past, it is important to tell your doctor before starting LUNESTA or any sleep medicine.

Withdrawal

Withdrawal symptoms may occur when sleep medicines are stopped suddenly after being used daily for a long time. In some cases, these symptoms can occur even if the medicine has been used for only a week or two. In mild cases, withdrawal symptoms may include unpleasant feelings. In more severe cases, abdominal and muscle cramps, vomiting, sweating, shakiness, and, rarely, seizures may occur. These more severe withdrawal symptoms are very uncommon. Although withdrawal symptoms have not been observed in the relatively limited controlled trials experience with LUNESTA, there is, nevertheless, the risk of such events in association with the use of any sleep medicine.

Another problem that may occur when sleep medicines are stopped is known as "rebound insomnia." This means that a person may have more trouble sleeping the first few nights after the medicine is stopped than before starting the medicine. If you should experience rebound insomnia, do not get discouraged. This problem usually goes away on its own after 1 or 2 nights.

If you have been taking LUNESTA or any other sleep medicine for more than 1 or 2 weeks, do not stop taking it on your own. Always follow your doctor's directions.

Changes In Behavior And Thinking

Some people using sleep medicines have experienced unusual changes in their thinking and/or behavior. These effects are not common. However, they have included:

- More outgoing or aggressive behavior than normal
- Confusion
- Strange behavior
- Agitation
- Hallucinations
- Worsening of depression
- Suicidal thoughts

How often these effects occur depends on several factors, such as a person's general health, the use of other medicines, and which sleep medicine is being used. Clinical experience with LUNESTA suggests that it is rarely associated with these behavior changes.

It is also important to realize it is rarely clear whether these behavior changes are caused by the medicine, are caused by an illness, or have occurred on their own. In fact, sleep problems that do not improve may be due to illnesses that were present before the medicine was used. If you or your family notice any changes in your behavior, or if you have any unusual disturbing thoughts, call your doctor immediately.

Pregnancy And Breastfeeding

Sleep medicines may cause sedation or other poten effects in the unborn baby when used during the last wee of pregnancy. Be sure to tell your doctor if you are pregna if you are planning to become pregnant, or if you beco pregnant while taking LUNESTA.

In addition, a very small amount of LUNESTA may be prese in breast milk after use of the medication. The effects of v small amounts of LUNESTA on an infant are not know therefore, as with all other prescription sleep medicines, i recommended that you not take LUNESTA if you are brea feeding a baby.

Safe Use Of Sleep Medicines

To ensure the safe and effective use of LUNESTA or any oth sleep medicine, you should observe the following cautior

1. LUNESTA is a prescription medicine and should used ONLY as directed by your doctor. Follow yo doctor's instructions about how to take, when to tak and how long to take LUNESTA.
2. Never use LUNESTA or any other sleep medicine t longer than directed by your doctor.
3. If you notice any unusual and/or disturbing though or behavior during treatment with LUNESTA or a other sleep medicine, contact your doctor.
4. Tell your doctor about any medicines you may taking, including medicines you may buy without prescription and herbal preparations. You should al tell your doctor if you drink alcohol. DO NOT use alcoh while taking LUNESTA or any other sleep medicine
5. Do not take LUNESTA unless you are able to get 8 more hours of sleep before you must be active aga
6. Do not increase the prescribed dose of LUNESTA any other sleep medicine unless instructed by yo doctor.
7. When you first start taking LUNESTA or any oth sleep medicine, until you know whether the medic will still have some effect on you the next day, u extreme care while doing anything that requir complete alertness, such as driving a car, operati machinery, or piloting an aircraft.
8. Be aware that you may have more sleeping probler the first night or two after stopping any sleep medici
9. Be sure to tell your doctor if you are pregnant you are planning to become pregnant, if you becor pregnant, or if you are breastfeeding a baby wh taking LUNESTA.
10. As with all prescription medicines, never sha LUNESTA or any other sleep medicine with anyo else. Always store LUNESTA or any other sleep medic in the original container and out of reach of childre
11. Be sure to tell your doctor if you suffer from depressio
12. LUNESTA works very quickly. You should only ta LUNESTA immediately before going to bed.
13. For LUNESTA to work best, you should not take it wi or immediately after a high-fat, heavy meal.
14. Some people, such as older adults (i.e., ages 65 a over) and people with liver disease, should start wi the lower dose (1 mg) of LUNESTA. Your doctor m choose to start therapy at 2 mg. In general, adul under age 65 should be treated with 2 or 3 mg.
15. Each tablet is a single dose; do not crush or bre the tablet.

Note: This summary provides important information abo LUNESTA. If you would like more information, ask yo doctor or pharmacist to let you read the Prescribi Information and then discuss it with him or her.

Rx only

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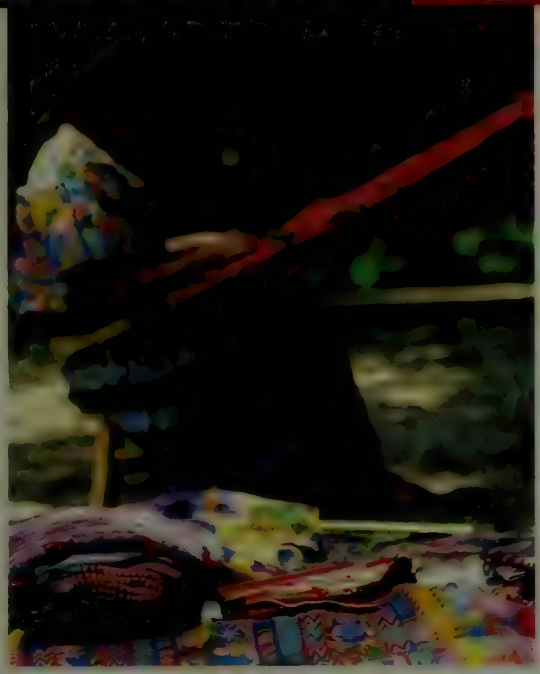
gistration fee and waited to learn out our host family.

My friend and I tend to be do-it-urselfers, but many prospective ıdents use agencies to help them rt through the choice of country, y, and school. The registration fee ay be larger going through agen-s than if you contact the school di-ctly, and there may be other arkups as well. But they will range lodging (schools will also lp you find housing if you contact em directly) and take care of the in-rnational calls and money transfers ble). Some throw in travel insur-ce, an emergency message service, d a pre-departure package with eful logistics.

If you're not sure where you want study, you'll be amazed at the ope of your options. For Spanish there e the usual suspects—Cuernavaca, adrid, Buenos Aires, Quito, and the e—but you can also explore a less trav-ed country such as Nicaragua or visit ru's Cusco. Italophiles should check out ily or Sardinia. For housing you can oose from a hotel—Antigua has some xury accommodations—or a room or parate apartment in a local home. me schools offer their own housing.



ON THE STREET Local textiles are a bonus (above) for students at Antigua's many language schools (right)

EAD FOR THE HINTERLANDS

NOTHER OPTION IS to live in the home your private instructor. Depending on e country, that can run from $2,000 to ,000 per week. Agencies that offer this y they're able to hook students up with achers who live in upscale homes, even U.S. standards.

If I weren't so intrigued by Tikal, I ight have chosen Costa Rica. Margot aldenby, program director at agency nguages Abroad, favors Costa Rica over a country such as Guatemala because she says the instruction is better, thanks to a more established middle class and a better education system.

There are advantages to avoiding the large urban centers. People don't have the standoffishness of some city dwellers, and since fewer of them speak fluent English, you're sure to get lots of practice. "In big cities some people think they're doing you a favor by responding in English when you ask them a question in Italian," says Suzanne Martin-Reay, a friend who has been to three schools in Italy. "Others speak to you in a way that makes you feel like you're holding them up, and then I get tongue-tied."

That wasn't the case in Cefalù, a Sicilian town where Suzanne and her husband David went to the Kulturforum school (www.kulturforum.it) for two weeks last November. "People would take the time to chat with you," she says. "I went to the same bakery every day and felt like I was a part of the community."

You can specify, say, a nonsmoking home

If you're living with a family, that happens naturally. When I arrived at the home of Marta and Luis Emilio Cuellar and their 3-year-old daughter Marcela, three other English-speaking students were there. Other household members included the roosters outside my bedroom window that crowed from 4 a.m. to 7 a.m. That sent me into the streets of Antigua on a quest for earplugs, or *tapones de oído,* which I learned are sold in hardware stores, or *ferreterías,* rather than *farmacias.*

You can make special requests. When Mitch Ginsburg, a school psychologist in Frederick, Md., decided to spend four weeks studying Spanish in Costa Rica with his 14-year-old son Sam last summer, he asked for a homestay with a nonsmoking family with kids. It turned out to be an ideal situation: On weekends, when Ginsburg went sight-

Where to Look for Guidance

23TEACHME 123teachme.com
This nonprofit's site includes lengthy student evaluations of schools. Compare schools by cost, instruction, and overall value. Lists programs combining language study with cooking, wine tasting, even surfing.

AMERISPAN amerispan.com
An agency that works with 85 partner schools in 35 countries. Its "program selection locator" is helpful, as are the "what we like/what we don't like" sections on individual programs. **800 879-6640**

T-SCHOOLS.COM
Devoted to schools in Italy. Covers language programs as well as arts and cooking programs. You can click on a map of the country to find schools by region—say, Tuscany—and get a list of schools and their Web links.

LANGUAGES ABROAD languagesabroad.com
An extensive, user-friendly site that offers a good general question and answer section along with school profiles that describe facilities, teacher backgrounds, instructional style, and after-class activities. **800 219-9924**

NATIONAL REGISTRATION CENTER FOR STUDY ABROAD nrcsa.com
In business since 1968, the company places students in schools in 42 countries, teaching 36 languages. The site does not go in-depth into individual schools. **414 278-0631**

TRANSITIONS ABROAD transitionsabroad.com
This in-depth site includes a wealth of reports by former language-school students, with lots of practical information, listings of program providers, language camps, learning aids, and other Web resources.

seeing, his son preferred to hang out with the family's 17-, 14-, and 6-year-old sons. Occasionally Sam would help the eldest, Esteban, with his English homework, while Esteban and his brothers taught their guest soccer moves.

Lynn MacDiarmid, head of worldwide tax services for Sotheby's and a veteran language-school traveler, has tried many housing options. When she went to Lingua Sì (linguasi.it) in Orvieto, Italy, in 2002, her homestay consisted of a large apartment with a separate entrance, kitchenette, fireplace, television, and a little courtyard. The next year she went to Bologna's Cultura Italiana (culturaitaliana.it) and was disappointed in the accommodations. The room was "shabby and dorm-like," she says. So last year, when she enrolled at Il Sasso (www.ilsasso.com) in Montepulciano, she went to tourist site nautilus-mp.com and found her own place. The apartment was just outside the historic town center, with a large bedroom, living room, kitchen, and a small terrace.

IN THE COURTYARD Antigua's Centro Linguistico Internacional

School facilities and teaching styles can also differ greatly. Katandria Johnson, a trilingual speech-language pathologist from Fort Worth, Tex., encountered many of them in her travels to 11 schools over 14 weeks in 2004 to fulfill a licens[illegible] quirement. In Barcelona, the En[illegible] school (enforex.com) has lots of co[illegible] ers and a structured program that involves a two-hour oral and written test to determine a student's level at the [illegible] At Centro de Lengua y Cultura in the Do[illegible]minican Republic, Johnson just sat down and talked with someone, then was paired with an instructor. "The school had lots of problems just keeping the electricity on," she notes.

GROUP OR ONE-ON-ONE?

BUSINESS-DEVELOPMENT consultant John Sturman wanted flexible, practical instruction when he went looking for a school in China. Agency FirstStep World (firststepworld.com) directed him to Mandarin House (mandarinhouse.cn) in Shanghai. Sturman wanted to learn how to ask a contact about Internet access or tell a manufacturer that a certain product needed to be darker or lighter. "One chapter we studied was how to get a haircut," he recalls. "So after that week I went to the barber shop and got a haircut."

Everyone in my school studied one-on-one with the same instructor, though you could ask to switch, which I did after one week. I enjoyed it and learned a lot. But some people prefer the energy of a larger group. Group lessons are less expensive, and many schools set a maximum number of students per class, often from 4 to 14. "I never sign up for private lessons until I get there, unless it's peak time," says Martin-Reay. "You can always upgrade, and you may wind up getting private lessons at the group price." But some schools may simply cut back your expected four hours of group lessons to 2½ hours if it turns out you're going solo.

The cost of your trip depends, in large part, on your housing and hours of instruction. Most students take four hours of instruction a day, usually in the morning. AmeriSpan estimates that two to three weeks of instruction in Spain, with housing and some meals included, could run $690 to $1,425; the agency says the same program in Latin America would cost $385 to $1,390. In Italy you might pay $885 to $1,500; in France, $1,000 to $2,140; and in China, $600 to $1,315. Of course, none of those numbers includes airfare.

My trip was a bargain. The $500 airfare to Guatemala City was the biggest expense. Four hours of daily instruction costs [illegible] per week, and my homestay, with all me[illegible] except on Sunday, was $60 a week. [illegible] I'll upgrade my accommodations. Perh[illegible]ps I'll spring for a private apartment in Costa Rica, just footsteps from a beac[illegible]

Before You Enroll...

Ask the following questions to make sure you have the information you need to make a smart decision.

INSTRUCTION

- How long has your school been in operation?
- Are the teachers university-educated?
- Does the school have a teaching philosophy? Describe a typical four-hour session.
- Can I contact former students for references?
- What is the maximum class size for group lessons? What is the average age of the students?
- Is there a system for switching teachers if I'm unhappy with mine?
- How are the classrooms set up? Are there indoor and outdoor teaching areas?
- What computer facilities are available?
- What cultural activities does the school offer?

COST

- Is there a penalty if I cancel or change my plans?
- Does the per-week cost drop after I've been at the school a certain number of weeks?
- What time of year is high season, and is there a discount if I attend in the "shoulder," or off season?
- Can I pay by credit card?

ACCOMMODATIONS

- If I choose a homestay, will there be other English-speaking students in the home? What are their ages?
- Is the school within walking distance?
- How much daily interaction can I expect with my host family? If I choose to do full room and board, will we eat all meals together?
- Is there a television or radio in my room or at the house so I can practice listening skills?
- Will I have a desk or study area in my room?

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EDITED BY TODDI GUTNER

DISASTER RELIEF

FOR KATRINA'S VICTIMS, A 401(k) LIFELINE?

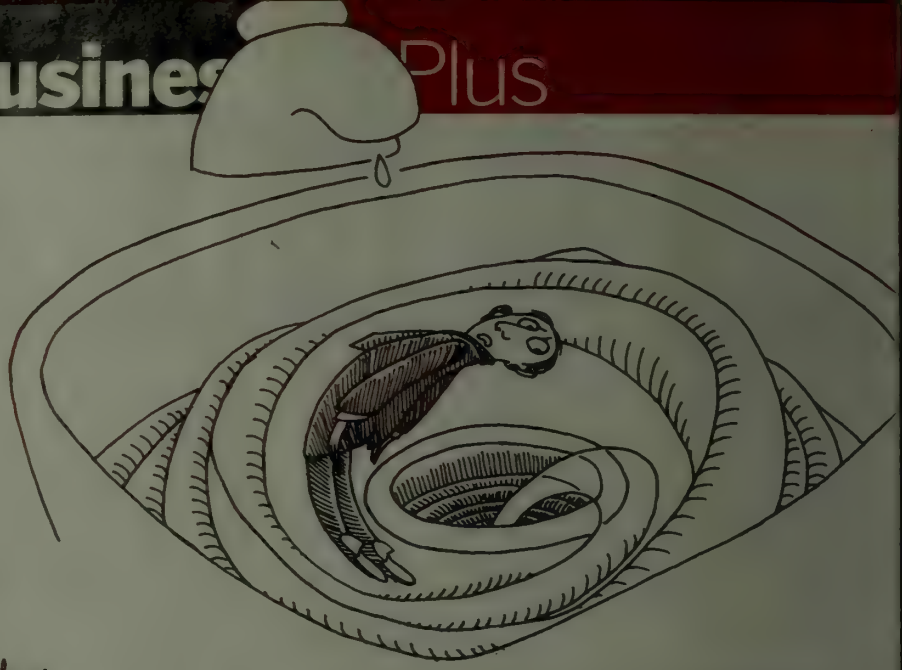
HURRICANE KATRINA victims may soon be able to tap their 401(k)s to help repair their broken homes. Various employer groups and retirement trade associations are pushing the U.S. Treasury for immediate implementation of a new "hardship distribution" provision that gives workers access to their 401(k) money for damage from a flood or hurricane.

The provision is part of a package of new 401(k) rules that employers are supposed to implement on Jan. 1, 2006. But given the dire need of Katrina victims, those behind the lobbying effort are hopeful the government will allow companies to put the hardship provision into effect early.

HELP IS COMING An attempt to speed "hardship distribution"

To qualify, a homeowner must show an "immediate and heavy need" for the money, must already have borrowed 50% of the 401(k) balance, and must have exhausted other funding options. Such distributions incur a 10% early withdrawal penalty for people younger than 59½ and regular income tax.

But Brian Graff, executive director of the **American Society of Pension Professionals & Actuaries,** says his organization and others are proposing that Congress also waive the 10% early withdrawal penalty and allow the tax bite to spread over a number of years, instead of just one. *–Ellen Hoffman*



Gahan Wilson

CIRCLING THE DRAIN

BOOKS

Biz Jargon Galore

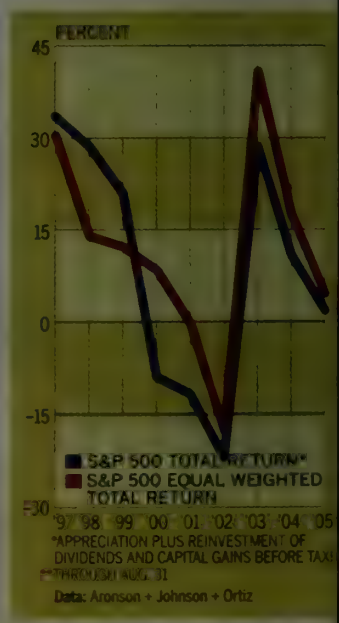
DO YOU ENJOY CHIPMUNKING? If you don't know what that means, you can pull out your BlackBerry to look it up on the Internet or get *Green Weenies and Due Diligence* by entrepreneur Ron Sturgeon (**Mike French Publishing,** $28.95). While many books define business words, this tome is definitely a Binaca blast (a breath of fresh air).

Green Weenies is a compilation of more than 1,200 business terms in two parts. The first is fun but useful. Ever been involved in an enterprise that's "circling the drain?" (It's failing.) Or heard a project referred to as "mouse milking?" (It's a venture with maximum effort for minimum returns.) The more sober half deals with standard business-and-investment jargon, from dilution to run rate and synergy. The entire book is enlivened by the comically grotesque illustrations of cartoonist Gahan Wilson.

At the greenweenies.com Web site, you can contribute your own "fortune cookie" that could be posted online or included in Sturgeon's next edition. Fortune cookie? It's "a witty way to refer to something you heard that is insightful." *–James Mehring*

STOCKS

THE STANDARD & POOR'S 500-stock index' 2% return so far this year (through Aug. 31) is paltry because the mega-cap stocks that dominate in the capitalization-weighted index remain in the doghouse. Viewed another way, though, equities don't look so bad. The equal-weighted version of the S&P 500, which treats smaller and midsize companies the same way as General Electric, is up nearly 5%. If the giants get some traction, the more familiar S&P could lead again. *—Lauren Young*



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DISASTER MAY MAKE DEMAND FOR AMN SERVICES SOAR.

CHESAPEAKE ENERGY IS IN AN INDUSTRY SWEET SPOT.

AT CVS, THE ECKERD PURCHASE IS PROVING TO BE A NEAT FIT.

AMN to the Rescue

IN THE WAKE OF THE KATRINA catastrophe, demand for health-care services to alleviate the suffering has exploded. One company that will help fill the gap, says analyst James Janesky of investment firm Ryan Beck, is AMN Healthcare Services (AHS), the largest national supplier of temporary nurses. Health-care providers, he says, will need to turn to staffing companies as many hospitals in the region have become inoperable—and patients have been relocated to facilities in nearby Florida, Georgia, and Texas. Even when these hospitals are back in operation, they won't have enough staff to handle the expected surge of patients, says Janesky. They will have to depend on outside sources, such as AMN. Exposure to toxic chemicals and bacteria in the cleanup efforts, he figures, will put further strain on health-care facilities. AMN recruits nurses and health-care professionals in the U.S. and overseas and places them on temporary assignments in hospitals and health-care clinics, which pay AMN for the temps. Some 93% of them are nurses; the rest are therapists and technicians. Health-care staffing is a $10 billion business, 65% of which comes from nursing help. AMN, now at 16.51 a share, is trading at 18 times Janesky's 2006 earnings estimate of 85¢ a share—a big discount to its peers, notes Janesky. He sees it hitting 21 in a year. His 2005 estimate is 64¢, vs. earnings of 55¢ in 2004. In 2004 it had more than 6,000 contracts for nurse staffing. Janesky says that he will raise his estimates depending on the increase in business due to Katrina. (Ryan Beck has done banking for AMN.) Also bullish on AMN are SunTrust Robinson Humphrey and Merrill Lynch.

CALLING ALL NURSES

Data: Bloomberg Financial Markets

Discover the e

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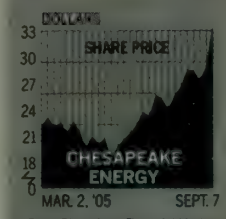
Gusher for Chesapeake?

S NATURAL GAS PRICES skyrocketed, so did shares of Chesapeake Energy (CHK), the third-largest independent gas producer. They jumped from 18 in d-May to 33.09 on Sept. 7. Does the ck still have pep? Absolutely, says chard Wolfe of Zacks Investment search. Chesapeake's vast acreage, owing fleet of drilling rigs, minant position in the U.S. mid-ntinent, and lack of Gulf operations derpin the positives, says Wolfe. n Maloney of M&R Capital nagement, which owns shares, s Chesapeake has leveraged itself gain from rising prices by gressively buying proved reserves. s 12-month target for the stock is 40. Wolfe of Zacks pects 2005 profits of at least $2.14 a share based on gas ces of $7 per thousand cubic feet this year. In Katrina's ermath, gas prices hit $11, so he has yet to firm up his 06 forecast.

NATURAL GAS IS BUBBLING

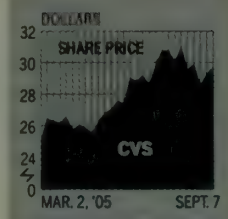


Data: Bloomberg Financial Markets

VS' Ever-Expanding Aisles

XPECT CVS (CVS), THE LARGEST U.S. drugstore chain, to get bigger—in size and profits. So argues Joseph Agnese of Standard & Poor's, who rates CVS a e-star "strong buy." A key driver is the 1,268 stores it quired when it bought Eckerd a year ago. CVS now owns more than 5,400 stores. Agnese sees revenue growth of some 20% in 2005, aided by the 10%-to-12% rise from buying Eckerd. There's potential for more improvement, he notes, with the Eckerd stores' yearly sales per square foot of $356, vs. $834 in core CVS stores. The Eckerd stores are a perfect fit, he says, because they sell more so-called front-end goods—nonpharmacy products such as over-the-counter drugs, cosmetics, snacks, even T-shirts. They deliver wider margins than prescription drugs, which account for 80% of total CVS sales. The aging population and improving pipeline of new drugs, he says, will help CVS achieve its goal of 15% overall long-term earnings growth. This year, Janesky expects CVS to open 125 new stores, up from 88 in 2004. He has upped his 2005 earnings estimate to $1.39 a share (from $1.34) on sales of $37.7 billion, and his 2006 estimate to $1.65 (from $1.51) on more than $40 billion in sales. Janesky's 12-month target for the stock, which rose from 25 on Mar. 2 to 29.85 on Sept. 7, is 38. CVS owns 330 stores in the Gulf area, but only 12 remain closed, says spokesman Mike DeAngelis. SunTrust Robinson Humphrey's David Magee doesn't think Hurricane Katrina will significantly impair total sales and earnings. He rates CVS "outperform." ■

FEELING REALLY GOOD



Data: Bloomberg Financial Markets

BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

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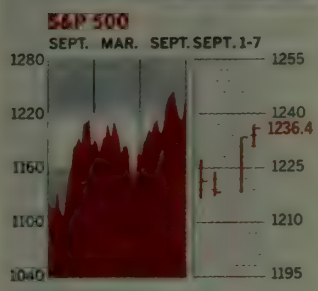
Personal Business Figures of the Week

STOCKS



COMMENTARY

As the floodwaters in New Orleans began to recede and oil sank below $65 a barrel, investors focused on the positives and sent stocks higher. Still, the economy continued to emit worrisome signals. Labor costs rose in the second quarter, while productivity lagged behind. Bonds fell as comments by Chicago Fed President Moskow suggested further rate hikes.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS

	SEPT. 7	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1236.4	1.3	2.0	10.3
Dow Jones Industrials	10,633.5	1.4	-1.4	2.8
NASDAQ Composite	2172.0	0.9	-0.2	16.9
S&P MidCap 400	718.4	1.0	8.3	22.1
S&P SmallCap 600	351.9	1.3	7.0	23.1
DJ Wilshire 5000	12,360.7	1.3	3.4	13.3

SECTORS

BusinessWeek 50*	744.3	1.4	5.6	15.6
BW Info Tech 100**	368.9	1.4	-1.1	14.6
S&P/BARRA Growth	592.0	1.3	1.7	5.6
S&P/BARRA Value	640.0	1.3	2.3	11.9
S&P Energy	387.5	1.7	34.3	47.9
S&P Financials	398.9	1.4	-3.0	1.3
S&P REIT	156.0	1.9	5.0	19.5
S&P Transportation	214.5	0.0	-11.2	4.8
S&P Utilities	168.1	2.3	18.7	31.6
GSTI Internet	177.7	1.9	-0.3	27.6
PSE Technology	820.3	1.4	5.3	25.3

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	SEPT. 7	WEEK	% CHANGE YEAR TO DATE	LA MO
S&P Euro Plus (U.S. Dollar)	1469.2	3.3	5.1	2
London (FT-SE 100)	5365.9	1.3	11.5	
Paris (CAC 40)	4485.2	2.0	17.4	2
Frankfurt (DAX)	4988.1	3.3	17.2	2
Tokyo (NIKKEI 225)	12,607.6	1.6	9.7	
Hong Kong (Hang Seng)	15,224.6	2.2	7.0	
Toronto (S&P/TSX Composite)	10,810.1	1.3	16.9	2
Mexico City (IPC)	15,245.2	7.0	18.0	4

FUNDAMENTALS

	SEPT. 5	WEEK AGO	YEA
S&P 500 Dividend Yield	2.02%	2.05%	1.7
S&P 500 P/E Ratio (Trailing 12 mos.)	19.3	18.9	19.
S&P 500 P/E Ratio (Next 12 mos.)*	15.4	15.1	16.
First Call Earnings Revision*	0.80%	0.47%	-0.0

*First Call

TECHNICAL INDICATORS

	SEPT. 6	WEEK AGO	REA
S&P 500 200-day average	1196.3	1095.4	Posit
Stocks above 200-day average	67.0%	59.0%	Neut
Options: Put/call ratio	0.83	0.87	Posit
Insiders: Vickers NYSE Sell/buy ratio	5.09	5.18	Negat

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Oil & Gas Refining	24.1	Oil & Gas Refining	137.3
Instrumentation	20.8	Fertilizers & Ag. Chems.	76.7
Agricultural Products	11.6	Oil & Gas Exploration	75.9
Oil & Gas Exploration	8.0	Managed Health Care	71.7
Educational Services	6.7	Oil & Gas Drilling	69.5

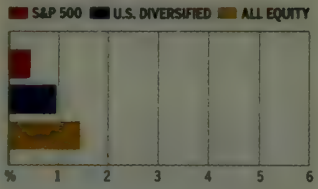
WORST-PERFORMING GROUPS

	LAST MONTH %		LAS MON
Footwear	-8.0	IT Consulting	-3
Specialty Appar. Retailers	-8.0	Automobiles	-1
Tires & Rubber	-7.8	Insurance Brokers	-2
Internet Retailers	-6.6	Motorcycles	-2
Hypermkts. & Suprcntrs.	-6.3	Aluminum	-1

MUTUAL FUNDS

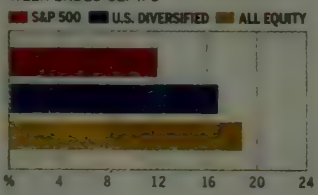
4-WEEK TOTAL RETURN

WEEK ENDED SEPT. 6



52-WEEK TOTAL RETURN

WEEK ENDED SEPT. 6



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Japan	9.7	Latin America	72.6
Real Estate	5.1	Natural Resources	54.4
Latin America	4.9	Diversified Emerg. Mkts.	42.9
Utilities	4.8	Europe	34.1
LAGGARDS		LAGGARDS	
Pacific/Asia ex-Japan	-0.3	Financial	8.9
Miscellaneous	0.4	Domestic Hybrid	10.4
Large-cap Growth	0.4	Large-cap Blend	12.3
Large-cap Blend	0.5	Miscellaneous	13.5

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Strateg. Ptnrs. Sm. Cp. Vl. A	14.4	Guinness Atkn. Gl. Energy	88.8
ProFunds Ultra Japan Inv.	12.6	U.S. Glbl. Invs. Gl. Rscs.	80.5
Scudder Japanese Eq. S	11.9	T. Rowe Price Lat. Am.	79.5
Rydex Large Cap Japan	11.7	ProFunds Oil & Gas Inv.	78.1
LAGGARDS		LAGGARDS	
iShares MSCI Taiwan Idx.	-5.7	Ameritor Investment	-56.0
ProFunds Bsc. Mtrls. Inv.	-5.5	ProFds. USh. Mid Cap Inv.	-33.3
Frontier MicroCap	-4.5	ProFds. USh. Sm. Cap Inv.	-33.3
Potomac Sm. Cap/Sh. Inv.	-4.2	Rydex Dyn. Vent. 100 H	-26.1

INTEREST RATES

KEY RATES

	SEPT. 7	WEEK AGO	YEAR
Money Market Funds	3.07%	3.04%	1.04
90-Day Treasury Bills	3.49	3.50	1.62
2-Year Treasury Notes	3.83	3.82	2.55
10-Year Treasury Notes	4.14	4.02	4.24
30-Year Treasury Bonds	4.42	4.26	5.01
30-Year Fixed Mortgage†	5.65	5.71	5.7

†BankRate.com

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BON
General Obligations	3.56%	4.30
Taxable Equivalent	5.09	6.14
Insured Revenue Bonds	3.74	4.38
Taxable Equivalent	5.34	6.26

THE WEEK AHEAD

PRODUCER PRICE INDEX *Tuesday, Sept. 13, 8:30 a.m. EDT* » August producer prices probably increased 0.7%, after a 1% jump in July. That's the median estimate of economists surveyed by Action Economics. Less food and energy, prices are expected to have risen 0.2%, after a 0.4% gain.

INTERNATIONAL TRADE *Tuesday, Sept. 13, 8:30 a.m. EDT* » The foreign trade deficit most likely widened to $60 billion in July. The June trade gap expanded to $58.8 billion.

RETAIL SALES *Wednesday, Sept. 14, 8:30 a.m. EDT* » Retail sales probably fell 0.2% in August. Vehicle discounting led to big gains in June and July. Excluding vehicles, retail sales very likely grew by 0.5%, following a 0.3% rise in July.

INDUSTRIAL PRODUCTION *Wednesday, Sept. 14, 9:15 a.m. EDT* » August industrial output probably grew 0.2%, after expanding 0.4% during July. The average monthly operating rate probably ticked up to 79.8%, after edging down to 79.7% for July.

CONSUMER PRICE INDEX *Thursday, Sept. 15, 8:30 a.m. EDT* » Consumer prices for goods and services are expected to have climbed 0.5% for a second straight month. Excluding food and energy, consumer prices probably rose 0.2%, after a 0.1% rise in July.

The *BusinessWeek* production index rose to 253.2 for the week ended Aug. 27 and stood 12.1% higher than a year ago. Before calculation of the four-week moving average, the index grew to 254.5.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit **www.businessweek.com/magazine/extra.**

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The Companies

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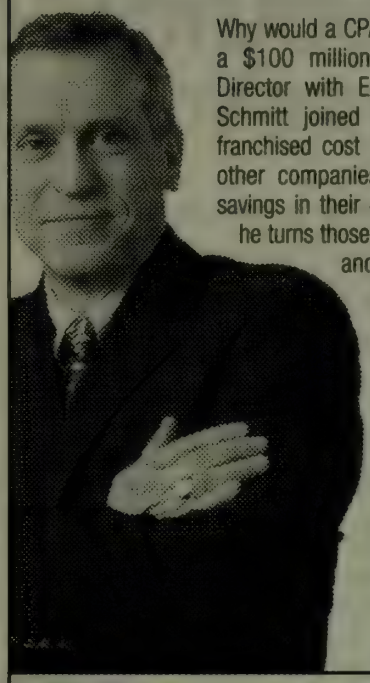

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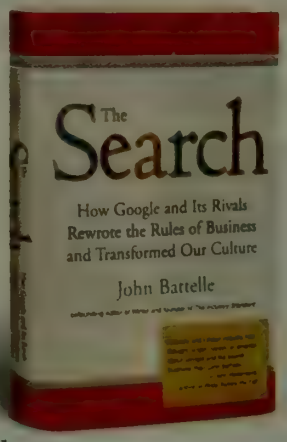
How Google Got Its Groove

THE SEARCH How Google and Its Rivals Rewrote the Rules of Business and Transformed Our Culture
By John Battelle; Portfolio; 311pp; $25.95

Google Inc.'s breathtaking success makes it difficult to recollect the search startup of five years ago: a cash-burning outfit with no business model, teetering one misguided decision away from the dot-com rubble. Indeed, had co-founders Larry Page and Sergey Brin followed conventional wisdom of the time—and the advice of consultants—and launched a multimillion-dollar marketing campaign in early 2000, Google could well have run out of money before it had a chance to mine the gold.

The Search: How Google and Its Rivals Rewrote the Rules of Business and Transformed Our Culture by John Battelle provides a compelling glimpse of the search industry's early years, covering the terrain and characters that contributed to Google's almost happenstance rise. But Battelle, who co-founded *Wired* and launched the now-defunct *Industry Standard*, sheds little new light on the modern-day Internet juggernaut in the months stretching from its tumultuous initial public offering to the present.



Written with the same cool-oozing verve that was a hallmark of his two magazines, Battelle marvels at the vast potential of Internet search. Sick of all the hoopla surrounding Google and its competitors? Just get used to it. For the first time in human history, we not only have uncounted terabits of information at our fingertips, but a large sampling of our wants, needs, fears, and desires are also being funneled in the form of search queries into the same place: the computer records of Google and its rivals. Battelle is awestruck by this aggregate digital artifact, which he dubs "the Database of Intentions." As Internet companies better understand our intentions and as search pervades everything from our PCs to TVs to cell phones, the power of the technology becomes intriguing—and a little scary.

Although Battelle frames the book with this riff, penning bookend chapters that provide a far-reaching picture of how search will affect our lives, the bulk of *The Search* is about Google—and some of its back story. Many readers may already be familiar with the tale of early search pioneers, such as AltaVista, whose rise and fall set the stage for Google; or GoTo.com, which revolutionized the business model of search with targeted pay-per-click ads. Even so, in Battelle's hands the tale is worth reading again. Full of color from firsthand interviews, it helps answer the basic question: How did Google jump so far ahead in this seemingly obvious bonanza of a market?

A familiarity with technology will help the reader: Acronyms such as WANs, LANs, and URLs tend to show up unexplained. However, Battelle's elucidation of early search technologies, and of Google's 1998 leapfrogging of the competition by analyzing the very links that connect the Web is surprisingly easy to digest.

Most tantalizing for Google aficionados will probably be the handful of early Google e-mails from 1997-98 unearthed by the author. Although only in their mid-20s at the time and operating out of Page's Stanford University dorm room, the two founders display a bullheadedness that borders on arrogance. In one exchange, Page seems to lecture Silicon Valley legend Vinod Khosla on market dynamics as the venture capitalist prods the duo to sell their technology to now-defunct Internet portal Excite for $750,000. Page's asking price: $1.6 million.

Such headstrong ways, in retrospect, seem to mark Page and Brin for success. Even a glimmer of self-doubt, after all, could have sabotaged the founders' seemingly naive decision to forgo an early marketing blitz or their choice not to clutter Google's pages with splashy banner ads. But stubbornness has also contributed to deep controversy: The company rankled Wall Street last year by eschewing a traditional IPO in favor of an auction of its shares and by vowing to operate in a different way from other public companies. And Google riled publishers this year with its aggressive efforts to scan, digitize, and facilitate searches of millions of books, despite cries of copyright abuse by some.

> Think what a different world this was five years ago—before you could "Google it"

Readers hoping for a new and insightful glimpse into such present-day Google topics, however, will be disappointed. Perhaps the author was stymied by the fact that Google, after leaning on the press for years to generate buzz, has now become one of Silicon Valley's most secretive outfits. Battelle, despite snaring numerous interviews with top brass, didn't come away with much to help flesh out the book's second half. For instance, the chapter on Google's IPO, perhaps the most covered business news event of 2004, is almost entirely devoid of new material.

Still, *The Search* is a worthwhile read for the illumination it offers on just how the Google craze got started in the first place. The answer is more interesting than you may remember. ■

–By Ben Elgin

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IdeasViewpoint

BY GLENN HUBBARD

Keep Your Eye on Japan

Political and business attention in the U.S. is focused on China's rapid and spectacular emergence as a global economic player. But the unfolding political drama surrounding Japanese Prime Minister Junichiro Koizumi's attempt to reform his country's antiquated financial system also contains some important lessons for the global economy. ¶ It's easy to see why interest in Japan has been eclipsed by that in China. With its economy growing by about 9% over the past year, China is galloping relative to Japan's slower growth of less than 2.5%. And many economists believe China's annual growth in gross domestic product could be 8% for many years, while Japan's potential GDP growth rate is closer to 1.5%. But this comparison, while likely, doesn't offer a fair assessment of Japan's potential cyclical contribution to global GDP expansion over the next few years. Japan remains the world's second-largest economy, with a GDP almost three times that of China. So a rebound in Japan—and there's growing evidence of one—would provide a much-needed boost to global growth now.

The financial reforms championed by Koizumi can raise the growth rates for both Japanese productivity and the economy. That faster pace would, in turn, reduce Japan's looming fiscal stresses. And successful financial reforms in Japan can offer a road map for economic restructuring in China, whose creaky financial system requires modernization if the mainland is to keep growing at a rapid rate.

The economy Koizumi inherited in 2001 had been languishing since the crash of Japanese equity and property markets in 1990. Banks struggled with nonperforming loans, racking up taxpayer bailout costs and channeling loans to large but insolvent businesses while strangling the abilities of new entrepreneurial businesses to obtain credit. And the '90s saw a big increase in public-works spending, benefiting the politically connected construction industry more than Japan's long-term growth.

KOIZUMI HAS MADE SUBSTANTIAL progress in banking reform. Japan's bank regulator is no longer a captive of its regulated clients. Nonperforming loans have been reduced. And wasteful public-works spending has been trimmed. Those developments have helped taxpayers and borrowers alike.

But Koizumi faces a far bigger challenge in his bid to break up and introduce competition for the postal system, Japan Post, whose $3.3 trillion worth of deposits and life insurance policies lie at the heart of Japan's financial restructuring and growth ills. By offering subsidized rates to depositors and policyholders, Japan Post puts private commercial banks and insurers—both Japanese and foreign—at a competitive disadvantage. That the funds are used in part to finance subsidized loans and public-works projects further distorts the nation's allocation of capital. A breakup of Japan Post would both stimulate competition in the financial sector and limit the flow of public funds to wasteful public projects. In short, picking this fight was a smart economic policy move.

And what a fight it is. Koizumi's plan was to split Japan Post into separate pieces for mail, banking, insurance, and property management. Government ownership (and preferential tax treatment and public guarantees) was to ce by 2007. His moves met with enormous politic opposition within Japan's ruling Liberal Democratic Party. When the Prime Minister lo a critical vote on the breakup in the Diet's upp house on Aug. 8, he pulled the brake, calling fo general elections for the lower house on Sept. 1

> The world has a huge stake in Koizumi's financial reforms

The U.S. has an economic stake in Koizumi's success. The postwar revitalization of the Japanese economy is one of the outstanding episodes in modern economic history. Better performance would continue this story for the next generation, while easing pressure on the U.S. economy to fuel global growth. A politicall and economically muscular Japan is a better al on the world stage. And successful restructuring in Japan serves as an example of the benefits of reform for emerging capitalists like China as well.

Investors would also benefit. China, of course, is today's star. But it and many other nations lack some of the special characteristics that make Japan so attractive to investors: a positive business climate, rule of law, advanced infrastructu a highly skilled workforce, and affluent consumers. Financi reform offers the best hope to further strengthen these positive attributes—and Japan's long-term growth. ■

Glenn Hubbard *is dean of Columbia Business School. He chaired the Council of Economic Advisers from February, 2001 to March, 2003. (rgh1@columbia.edu)*

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IdeasOutside Shot

BY MARK D. NAISON

Black Poverty's Human Face

Hurricane Katrina may well turn out to be the worst natural disaster in modern American history, surpassing hurricanes Andrew and Camille and equaling, if not exceeding, the San Francisco earthquake of 1906 in its destructive impact. The flooding and devastation of an historic U.S. city, coupled with the desolation of homes, stores, businesses, roads, and bridges along 80 miles of Louisiana, Mississippi, and Alabama coastline, presents an unprecedented humanitarian challenge whose effects will be felt for years to come.

But this catastrophe also reveals how deeply divided our nation is economically and racially. Our social fabric has been strained by policies that have widened the gap between rich and poor, leaving many of America's worst off feeling marginalized and alienated. Those who were left behind in a flooding city have just as surely been left behind in the society at large.

The full tally of Katrina's dead (including those who will perish in the days to come from heat, starvation, and diseases contracted from contaminated water) will no doubt confirm what the television images of rescue operations revealed: that the greatest suffering and loss of life occurred among Louisiana and Mississippi's black poor. It was they we mostly saw wading through the floodwaters in New Orleans streets, lining up to seek shelter at the Superdome and New Orleans Convention Center, and being airlifted from rooftops. Unlike September 11—which revealed a New York united in grief and determination to rebuild—this crisis highlights communities riven by race and class and in which poor blacks bear levels of hardship that far exceed any other group.

The Gulf of New Orleans

	BLACK	WHITE
Population	325,947	135,956
Per Capita Income	$11,332	$31,971
Number Living in Poverty	110,215	15,004

Data: U.S. Census Bureau, 1999, 2000

INDEED, NOT SINCE THE GREAT Mississippi River Flood of 1927 (when 330,000 blacks were displaced to camps) has the economic and racial isolation of the black poor been rendered in such stark relief by an environmental calamity. What the images Americans saw on the evening news revealed about who was dying, who was trapped, who was without food, who was drinking contaminated water—and, yes, who was looting—should give us all pause. Is this what the pioneers of the Civil Rights Movement fought to achieve—a society in which black people are as trapped and isolated by their poverty as they were by segregation laws?

Perhaps the only good to come from Katrina's wake will be those very images that chronicled its horror. The sight of tens of thousands of desperate black people crying for help outside the Superdome and the New Orleans Convention Center have had the same effect on viewers as the shots of Bull Connor turning firehoses and dogs on teenage demonstrators in Birmingham, Ala., in 1963. A hundred years from now, peop will regard those pictures as symbols of American civilizatio at the dawn of the 21st century and of the continued isolatio of poor blacks within the wealthiest nation on earth.

One of the things I learned living through, and participati in, the civil rights movement of the 1960s is the importance visual images. Without TV footage and news photos of segregationists beating peaceful demonstrators, the full horr of Southern segregation would have never mobilized either a world audience or the American public. Now, via Katrina, concentrated, racialized poverty in America has a human fac it never had before. And that face will live on in people's memories and nightmares as a permanent part o the historical record. How we deal with those images, and the conditions they reflect, will defin the character of this nation for decades to come.

That's why we must ask difficult questions about how Katrina played out. Would the respon to the destruction in New Orleans have been quicker if the majority of the victims were not poor people of color? Was government's reaction hampered by the strain the Iraq war has exerted on our military and the National Guard's ability respond quickly to crises at home?

In no way should these issues detract from the heroism of tens of thousands of rescue personnel and ordinary people who saved—and continue to save—lives along the battered Gulf. Each of us needs to support them ar the affected residents economically, politically, spiritually, an by any act of personal generosity that can ease the suffering.

But we cannot shrink from what this tragedy reveals abou America today. If September 11 showed the power of a natio united in response to a devastating attack, Hurricane Katrin exposed the fault lines of a region—and a nation—rent by profound social divisions. Fixing New Orleans' breached levees without repairing that greater divide will leave only half the job done. ■

Mark D. Naison *is Professor of African American Studies & History and Director of Urban Studies at Fordham University i New York, and author of* White Boy: A Memoir.

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"I'M OUTTA HERE!"

Why Microsoft s losing some key talent

JAY GREENE (P. 98)

us: Meet "Mini-Microsoft," the mpany's mystery blogger

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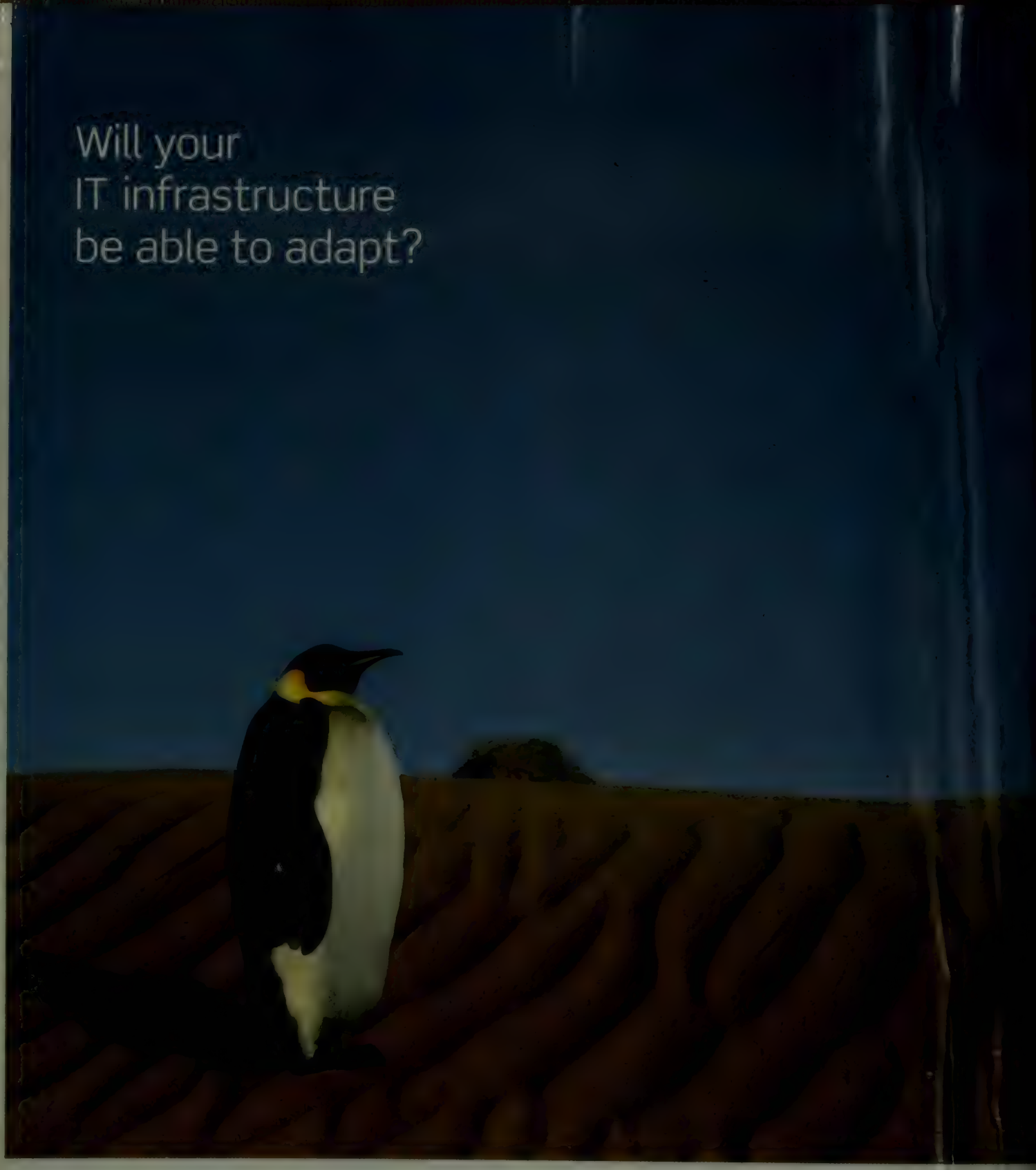

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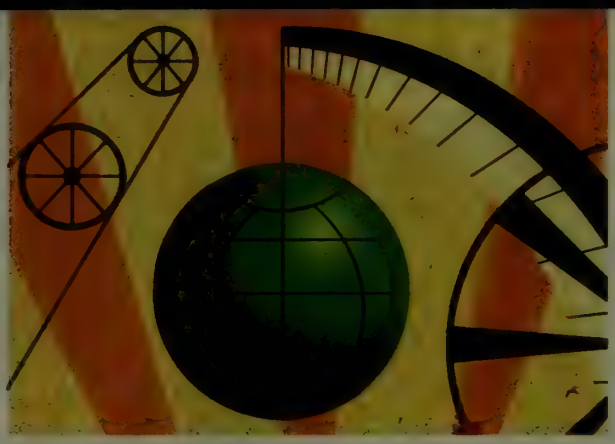

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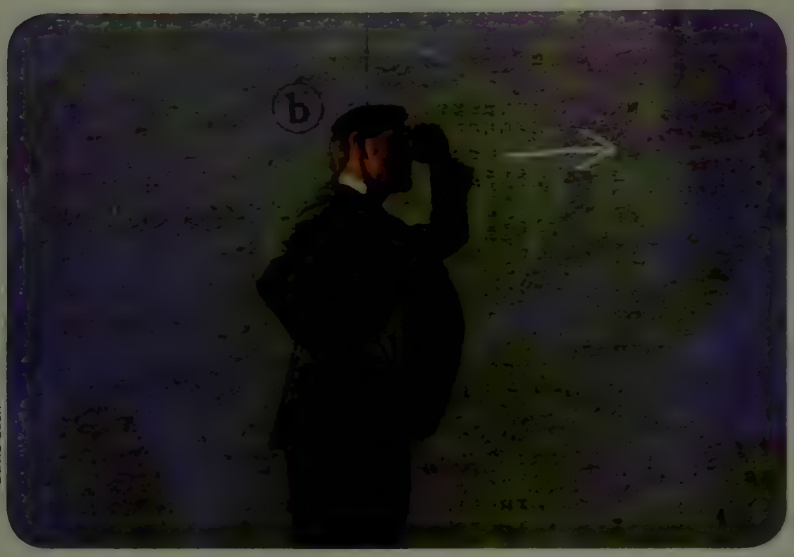

David Lesh

If there's one word that describes the challenges confronting today's businesses, it's growth. Growth in sales. In profitability. And in market share. So important has the emphasis on growth become that a company's stock can nosedive if its sales or net income fail to meet analysts' growth projections—even if sales and profits are up.

But generating corporate growth is not the straightforward matter it once was. As Thomas L. Friedman writes in his new book "The World Is Flat," the lowering of trade barriers and exponential advances in technology have made it possible to do business instantaneously with billions of people across the planet—and to do business from anywhere on the planet—almost regardless of company size. The result: established companies now often must struggle just to maintain their current position, much less improve it. Indeed, the current 'topple rate' (the frequency at which established companies lose their leadership position) has doubled since the 1970s.

A global survey conducted last year by IBM underscores just how difficult corporate growth is to achieve. Even though four out of five responding CEOs named growth as their top corporate priority, almost half strongly agreed that their companies were not currently reaching their growth potential. And among larger companies, fewer than one-third were highly confident that they would achieve their growth goals.

The Importance of Customers

So what's the answer? Research repeatedly demonstrates that the key to corporate growth is the same as it has always been: delivering the val that customers want, and delivering it in new and innovative ways. Harvard Business School profes Clayton Christiansen made this thesis the central point of his 1994 book, "The Innovator's Solution The secret to growth-promoting innovation, he sa lay in "breaking the mold" in satisfying customers needs and expectations. In fact, companies that differentiate themselves in this way are more than six times as likely to achieve their growth goals as are those that pursue more incremental approache

What's more, a study of high- and low-performing firms, carried out by Accenture earlier this year, uncovered that 40% of the difference in revenue growth and 38% of the difference in shareholder value was due directly to their ability to enhance customer loyalty. And a 2004 survey by the University of Michigan's National Quality Research Center determined that increasing a company's customer satisfaction by just 1% was associated with a 3% increase in market capitalization.

Embracing the Opportunity

Yet most corporations don't seem to be getting the message. A 2004 Deloitte survey of 150 technology CEOs—a group one would presume was highly skilled in using innovation to deliver greater customer value—discovered that just 6% of these firms view customer loyalty as their biggest challenge to sustaining revenue growth. Bringing new products to the marketplace, hiring salespeople and developing strategic relationships all ranked higher.

While recognizing the importance of customers to corporate growth is critical—it's only the first step How do firms develop sound customer-focused strategies and then mobilize the right combination of people, processes, and technology to bring those strategies to life? How do they translate their customer-focused initiatives into actual improvements in revenues, profits, and market share? We'll explore these vital questions and others in upcoming articles in this series.

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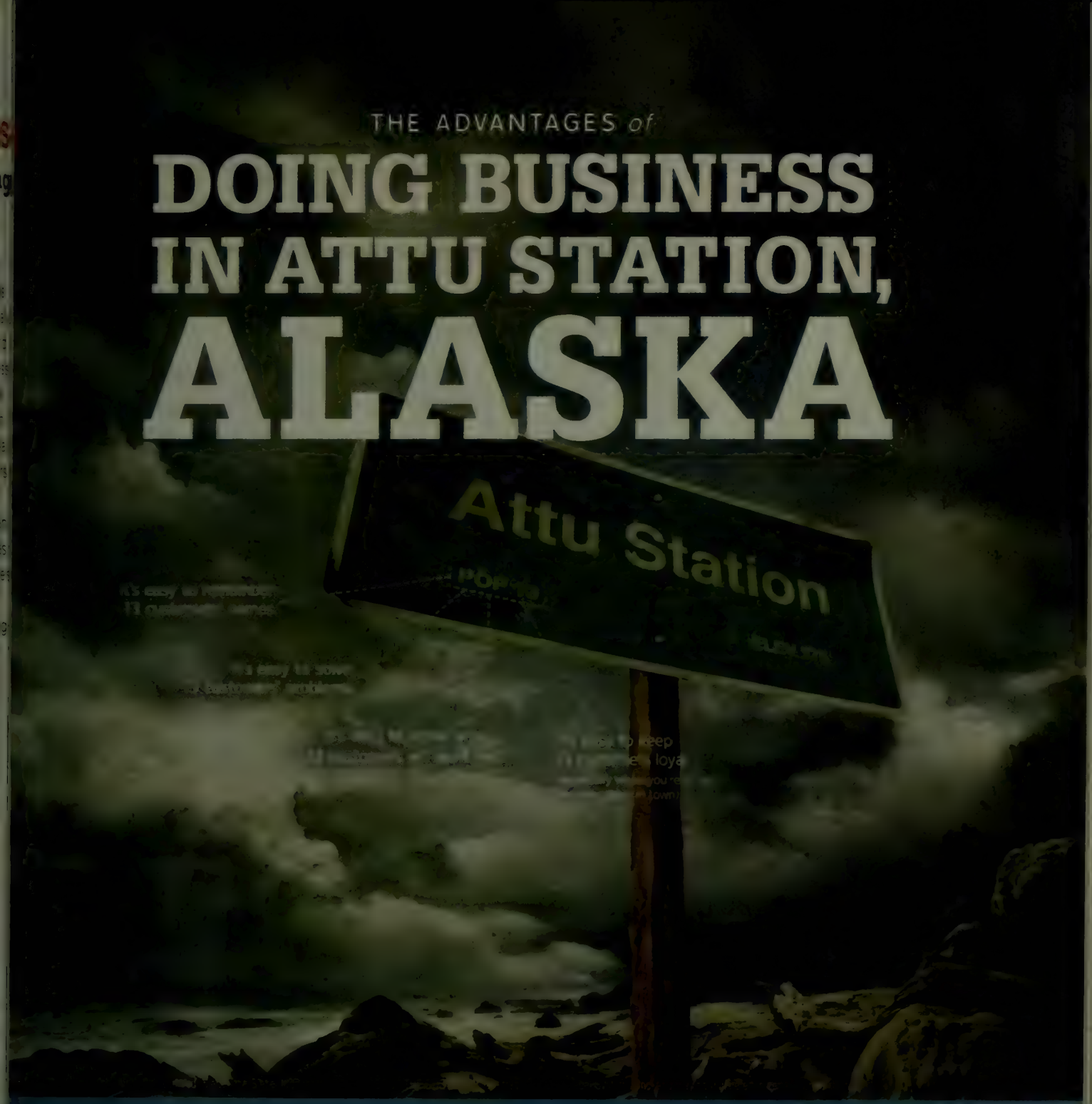

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Special Report: Rebuilding After Katrina

In this extensive series of stories, we examine the challenges and opportunities now facing the Gulf Coast—and the U.S. **Should New Orleans be rebuilt?** And if so, how? Is Houston the model, or post-9/11 New York, or even Venice? Hear from an expert who urges the city to **build on its creativity,** embrace green technology—and above all, act boldly. Also: How the hurricane slammed **small businesses** and how they can cope. Why **Wall Street** took the calamity in stride. Which **companies might benefit** from the rebuilding. And lots more

Japan's Quiet Technology Giant

With up to an 80% market share in Hoya's core businesses—which include the manufacture of key components for iPod hard drives—the Tokyo outfit is now rated 5 STARS from Standard & Poor's

HOYA

Designer Liz Lange's Labor of Love

Ignoring doubters, Lange borrowed $50,000 to open her first store in New York City in 1998, and soon had mothers-to-be—plus Target and Nike—lining up for her chic maternity clothes

Tech IPOs Are Clicking Once Again

As the Internet bubble slips further into history, investors are itching to get back in on the action. Looks like plenty of startups will be eager to oblige

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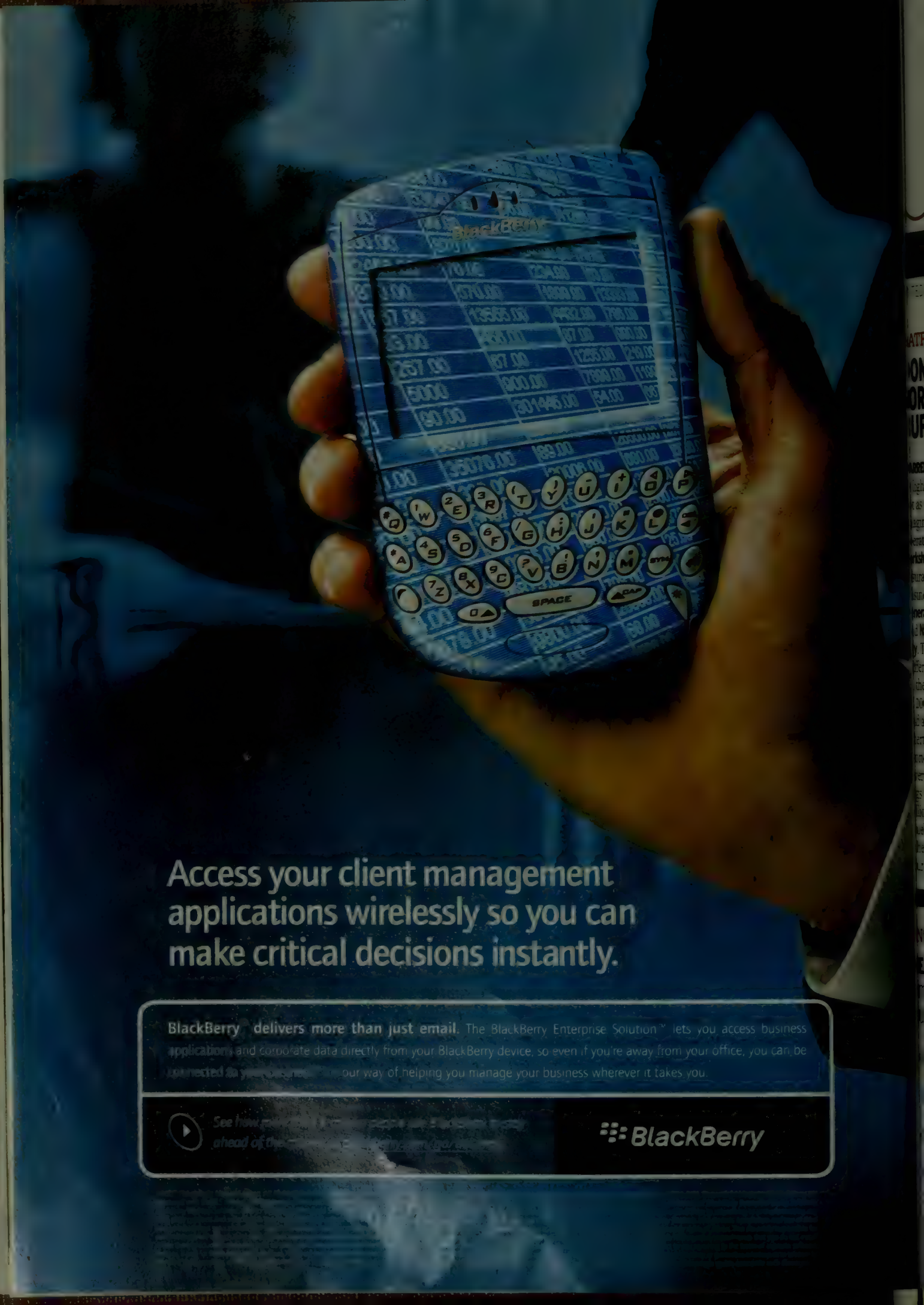
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UPFront

"We're not played out as a species."

–Gregory Wray, Duke University biology professor, on two new studies that say the human brain is still evolving, to the Chicago Tribune

ITED BY DAN BEUCKE

ATRINA CLEANUP

ON'T CRY OR WARREN UFFETT

RREN BUFFETT'S wallet may lightened by Katrina—but as much as you might agine. Sure, about 60% of erating earnings at **rkshire Hathaway** are from urance-related sinesses like **neral Re, GEICO, l National Indem-**. They could fer steep losses. the third quarter 2004, Berkshire l a $816 million ertax loss from rida hurricanes. erall, net earn-s fell 37% then, to $1.1 ion. Katrina could be eler. But Berkshire, like er insurers, is coming off r years of rising prices. It has a capital base of $88 billion. Katrina losses are "likely to be a mosquito bite for Berkshire," says **Morningstar** senior stock analyst Dreyfus Neenan.

Other investments should soften the blow. Buffett has long been a fan of home-building, owning paint maker **Benjamin Moore,** carpet supplier **Shaw Industries,** and **Clayton Homes,** the No. 1 retailer of manufactured homes. All could benefit as cities rebuild. FEMA has ordered 1,800 Clayton mobile homes to house evacuees. Clayton cut prices for the government but expects a small profit. Finally, if energy remains pricey, Berkshire has a 1.3% stake in oil producer **PetroChina**. Being super rich means never having to put all your eggs in one basket. *–Adrienne Carter*

SAFE & DRY Losses will be offset

ISURANCE

EALTH HAZARDS Over the past five years, mployers have hiked workers' annual contri-utions for family health coverage by 68%

Data: Kaiser Family Foundation/Health Research & Educational Trust 2005 Employer Health Benefits Survey

LOGGED IN Data goes to a central base

WIRED LIFE

E-Health Gets a Shot in the Arm

SILICON VALLEY HAS TALKED A GOOD GAME about digitized health care, a sort of information superhighway for hospitals and doctors. Now big tech outfits are putting their muscle behind it. This week, **Cisco Systems, Intel,** and **Oracle** disclosed an alliance to subsidize adoption of technology by Bay Area doctors. If they comply with standards for automating their offices, such as using electronic records and promoting online patient education, the docs can get paid up to 5% more for treating employees of those companies. Cisco medical director Jeffrey Rideout says the aim is higher-quality care: "We believe lower costs may be a consequence, but it's not a primary goal."

Still, savings estimates keep growing. A Sept. 14 **RAND** study, reported in the journal ***Health Affairs,*** says the proposed National Health Information Network of electronic medical records could save up to $165 billion a year, from the total $1.7 trillion U.S. health-care bill, by shortening hospital stays, encouraging tests and early treatment, and cutting administration costs. That's 50% higher than previous estimates. Skeptics like **Harvard's** Steffie Woolhandler and David Himmelstein say the report uses speculative economic models and that hospital-based computing is little improved over 20 years ago. Also, RAND's work was backed by tech suppliers. But with government—and now employers—pushing, the e-health movement is gaining speed. *–Timothy Mullaney*

UPFront

MAD AVE

BUILDING THE FLOCK IN PRIME TIME

FACED WITH stagnant growth, the **United Methodist Church** is turning to Madison Avenue for answers. The church recently launched an ad campaign targeting Gen X professionals just starting families—the same 24-to-44-year-olds coveted by sellers of soft drinks and cell phones. The campaign, created by **The Buntin Group** of Nashville and running nationally on **CNN** and elsewhere, plays on a "journey toward faith": in one, people follow trails of pebbles, arrows, and red yarn until they meet each other.

METHODISTS Marketing faith on TV

The Methodists have dabbled in seasonal ads, but spokesperson Stephen Drachler says the new campaign is their largest outreach push. No wonder: The number of Methodist lay members fell 0.7% from 2002 to 2003, to 8.2 million. They aren't alone: The **Episcopal Church** is launching a smaller campaign, spurred by its own 1.6% membership decline between 2002 and 2003. **Southern Baptists,** meanwhile, grew by 0.4% during that time. The Methodist ads will cost $25 million over four years and will go forth and multiply via radio, print, and billboards. *–Elizabeth Woyke*

BOMBS AWAY

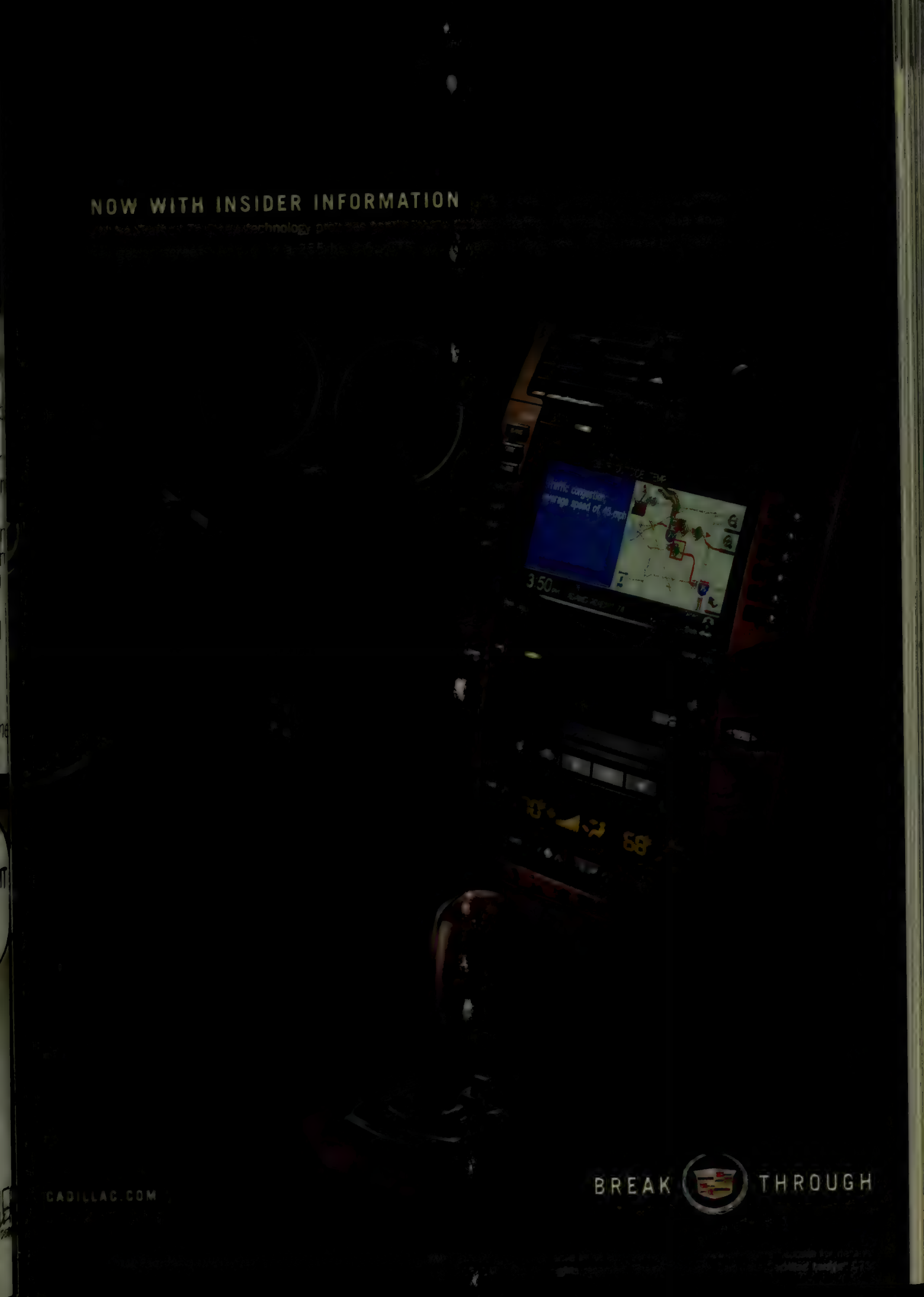
STAYING ALOFT It outlived the Cold War, did a star turn in *Dr. Strangelove* (above), and has flown in every post-World War II conflict exce Korea. Now the Air Force is finding ways to keep the B-52 Stratofortress bomber aloft fo another 35 years. Pentagon planners are givi the Boeing-built B-52 a bigger role in electronics jamming and are thinking about buyi an advanced radar system to keep it flying ur 2040. At that point some B-52s would be 80 years old—the equivalent of the Wright Brothers' plane flying until 1983. With a minimal investment, the world's sturdiest airframe continues to play a crucial strategic role—providing a rare example of fiscal common sense inside the Beltway. *–Stanley Holm*

PODCAST NEWS

A BOND GURU ON YOUR iPOD

WITH NEARLY $500 billion under his watch, Bill Gross is one of the bond market's most powerful investors. But Gross is also a Luddite: He writes his influential monthly investment outlook with a pencil and paper. Starting in October, though, Gross will also read a podcast at **pimco.com** and **itunes.com**. His musings aren't your basic fixed-income slog: Recently he discussed his no-sugar diet along with rising rates. But even Gross isn't sure how it will go: "Why would you spend time listening to me instead of the new U2 album?" *–Lauren Young*

DRAWN & QUARTERED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FACE TIME

STEVE ELLS

NOW THAT'S ONE HOT CHIPOTLE

When Steve Ells opened Chipotle Mexican Grill 12 years ago in Denver, the formally trained chef thought his little taqueria would be a cash cow to underwrite "a real restaurant" with cloth napkins and waiters. "I thought there was going to be just one Chipotle," Ells says. So much for his forecasting skills. Today, Chipotle is the fastest-growing U.S. chain, with 450 outlets and estimated sales north of $600 million. And soon it may generate even more cash. McDonald's, which bought a stake in 1997 and now owns 90% of the company, is mulling a spin-off as it focuses on its core operations. McDonald's execs say nothing has been set, but analysts think an announcement could come in weeks.

In any case, Ells, 39, says he has no intention of stepping aside as CEO. (He and his partners own 10% of Chipotle.) And he no longer yearns for that "real" restaurant. "I am more and more invigorated by Chipotle," he says. Judging by its sales, so are his customers. *–Michael Arndt*

MARKETING

FOR UPS, A FASHION WEEK FANTASY

THE BROWN SHIRT and pants of **United Parcel Service** delivery staff are among the most recognizable outfits in business. But that didn't stop UPS from asking students at New York's **Fashion Institute of Technology** to rethink the concept. Six of the whimsical designs they came up with last year were stitched into uniforms, and photos of the outfits were displayed by UPS as part of its sponsorship of Fashion Week, the annual industry fete held in New York's Bryant Park from Sept. 9-16. The looks ranged from a safari-inspired shorts jumpsuit with cargo pockets to a hooded capelet, handknit sweater, and snazzy holder for the driver's Delivery Information Acquisition Device. The color palette: browns, of course, dressed up with official UPS patches.

UPS wants to expand its global logistics and supply-chain business in fashion, so the sponsorship was a natural fit. UPS won't reveal what it paid, but it gave 10 emerging designers a venue for their shows. That's a big break fo the designers, since a show one of Bryant Park's lavish tents costs $25,000 to $50,000 before models' fee and production costs.

For UPS, it was purely a exercise in marketing—do expect new uniforms to hit the street anytime soon. *–Christine Summer*

LIBATIONS

A VODKA FROM THE LAND OF ITS BIRTH

AMERICAN DRINKERS have developed quite a taste for vodka, knocking back $8 billion of the stuff last year. But not a drop of it was made in Russia: Smirnoff has been distilled in the U.S. for generations by Hartford's **Heublein**, now part of British **Diageo**, while Stolichnaya, another famous brand originating in Russia, is made in Latvia these days.

Now flamboyant Russian multimillionaire Roustam Tariko is hoping to change that. This month, Tariko began exporting Imperia, the most exclusive variant of **Russian Standard**, a seven-year-old premium brand that has caught fire with the Russian jet set. Russian Standard sales in Russia climbed 20% last year, to $100 million.

Imperia, which sells for around $35 a bottle, plays on Russian nostalgia with double-eagle labels that say "1894 St. Petersburg." But it faces a daunting challenge in getting noticed in the U.S. alongside such luxury brands as France's Grey Goose, and Poland's Belvedere.

Tariko already has shown a knack for American-style marketing: To launch his invasion of the U.S. on Sept. 7, the tycoon rented Liberty Island, site of the Statue of Liberty, for an exclusive party. *–Jason Bush*

THE STAT

8.3

United Airlines' share of the U.S. airline market as of May. That's down from 10.7% in December, 2002, when its parent, UAL Corp., filed for bankruptcy protection. In that time, United's workforce has dropped 18%. Management filed its reorganization plan with the court on Sept. 7.

Data: U.S. Transportation Dept., United Airlines

TO SURVIVE IN THIS DOG-EAT-DOG WORLD, SOMETIMES YOU NEED A LITTLE PUDDING.

At the end of the day, even the most battle-hardened road warrior appreciates a cup of sweet, smooth tapioca. Or cool, creamy pistachio ice cream. Or a slice of steaming hot pizza pie. Whatever business travelers' intrepid hearts desire, the new 24-hour markets in Courtyard's redesigned lobbies have what it takes to satisfy them.

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"Genetics and personalized medicines ... will not remove the intrinsic risk associated with medicines."

–Albert Ren
North Wales, Pa.

THE PROMISE AND LIMITATIONS OF SMART DRUGS

AS A SCIENTIST, I still remember the excitement after hearing the presentation of Dr. Francis Collins (director of the Human Genome Project) and can't wait to see how genetics and personalized medicines mature and benefit mankind ("Drugs get smart," Cover Story, Sept. 5). But this only improves the ratio of benefit (screen who may have the genetic profile to respond to a drug) to risk (identify the subpopulation with different metabolizing powers). It will not remove the intrinsic risk associated with medicines.

As pharmacologically active compounds, medicines will have some intrinsic toxicities. Some molecules will probably have off-target activities (i.e., they will hit receptors other than the intended target). Some molecules will hit the biological pathways that are associated not only with disease but also with other, normal biological functions. How we strike the balance among risk, benefit, and cost will define the health-care system.

–Albert Ren
North Wales, Pa.

IN YOUR OTHERWISE well done story, you wrote that Roche's AmpliCh CYP450 "is the first genetic test approv by the Food & Drug Administration to ide tify responses to a wide variety of medic tions." This is technically true, but tests f the gene variants targeted by the Amp Chip have been available at many clinic labs for years without specific FDA a proval. That's because approval is not nee ed for tests developed and performed b qualified labs as long as they aren't market commercially as packaged kits or device

Also, Roche initially tried to market t AmpliChip in July, 2003, without FDA a proval. The agency immediately sent th company a warning letter, and Roch spent months trying in vain to persuad the FDA that the AmpliChip was not a d vice needing pre-market review. Th foolishness kept AmpliChips off the U. market for more than a year.

–John Gev
Morgantown, W. V

Editor's note: The writer is editor of th newsletter *Diagnostics Intelligence*.

AS ECONOMIC ADVISER to a leadin Swiss pharmaceutical company for years, I read "Drugs get smart" and foun only one sentence that is fully in line wi

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ReadersReport

CORRECTIONS & CLARIFICATIONS

"An ugly battle for the clicker" (Media Centric, Sept. 5) incorrectly referred to "9600-baud" online connections. The correct term is "9600 bits per second."

The photo accompanying "Let that be a warning" (Cover Story, Sept. 12) was the US Highway 90 bridge, not I-90.

In "TCL's French meal leads to indigestion" (Global Wrapup, Sept. 12), we incorrectly stated that TCL Multimedia took control of the RCA brand. TCL licenses the brand from Thomson.

my decades of health-care experience: "More than 100,000 people die from drug side effects each year [in the U.S. alone]."

Health care's weapons of mass destruction: the Standard American Diet (SAD)—with so many Americans overweight—and our so-called high-tech drugs, which merely suppress symptoms and never deal with causes.

–Otto H. Nowotny
Basel, Switzerland

MANUFACTURED-HOME PARKS: A BOOBY TRAP FOR BUYERS

RE "SHARKS in the housing pool" (News: Analysis & Commentary, Sept. 5): Across the country, corporate owners of manufactured-home parks are perpetrating a mortgage swindle that victimizes both banks and local communities. Manufactured homes are sold to unsuspecting owners who also must rent the land the home sits on. When the homeowner wants to sell, all the park owner needs to do is raise the land rent so outrageously that no new owners appear. Unable to sell, the owner or his or her heirs are forced to surrender the home to the bank. The park owner can then retake the home and sell it again to new victims.

–Linda Ponzini
Watsonville, Calif.

JUST HOW INNOVATIVE IS GOOGLE?

DESPITE BEING heralded as one of the world's most innovative companies, every "innovation" that Google Inc. seems to have planned is either an acquisition or a replication of an existing idea ("Google's grand ambitions," News: Analysis & Commentary, Sept. 5). The company's true strength is in its brand—and really only in search. Google needs to remember that, or else all of these brand extensions won't mean anything. Unfortunately, there already seems to be a growing revolt among some of tech's savviest, as Google's search-engine-results pages (SERPs) fall behind those of MSN's and even Yahoo!'s.

AdWords and AdSense are both great programs, but enrollment is high only because Google is the Wal-Mart of search (both attract big audiences, which allow them to take an "our-way-or-no-way" stance). If Google's search falls behind any further, the door will be open for new search technologies to claim the throne—and the accompanying ad revenue.

–J.D. Amer
Akron, Ohio

KRAFT'S "HEALTHY" MEAL? YOU MAY AS WELL EAT CANDY

I CAN'T BELIEVE *BusinessWeek* swallowed the junk they served you at Kraft Foods Inc. ("Slimmer kids, fatter profits?" People, Sept. 5). Its supposedly healthy "pizza de resistance" has 36 grams of sugar. For comparison, a "fun-size" Butterfinger bar has 10 grams of sugar. In other words, Kraft's "healthy" meal has about four times as much sugar as a serving of candy. They don't need to worry about the dessert they include in their Lunchables Lunch Com nations: The whole thing is dessert!

–C. Andrew Aligne, M
University of Roche
Rochester,

Editor's note: The writer is a pediatric public-health researcher, and childre health advocate.

IT'S ALL WELL and good for Kraft to prove the nutritional value of its meals, what is the overall benefit ? A 200% crease in fiber is probably a good thing, what was the starting point? What is overall nutritional value of these "foo following the improvements? As for K slimming down the Oreo, it tastes good way it is. How about eating one or cookies at a time, not an entire bag?

–Pamela R. Ch
Bos

BEGGING TO DIFFER ON BUSH'S HANDLING OF THE ECONO

IN "CAN THE DEMOCRATS seize day?" (Washington Outlook, Aug. 22/ Richard S. Dunham says "voters have it with President Bush's handling of

nomy." Then, in "Sticking to the sweet t" (Corporate Scoreboard, Aug. 22/29), *inessWeek* reports that "profits have n for 10 straight quarters" and "thanks robust economy...profits for the 900 npanies on *BusinessWeek*'s Corporate reboard rose by...20% in the second rter." This is accompanied by a photo shoppers lined up, captioned "Costco cashed in on consumers' eagerness to p." It seems to me that consumers are oying the Bush tax cuts and are busy ling our economy.

–Jim Wallwork
Chevy Chase, Md.

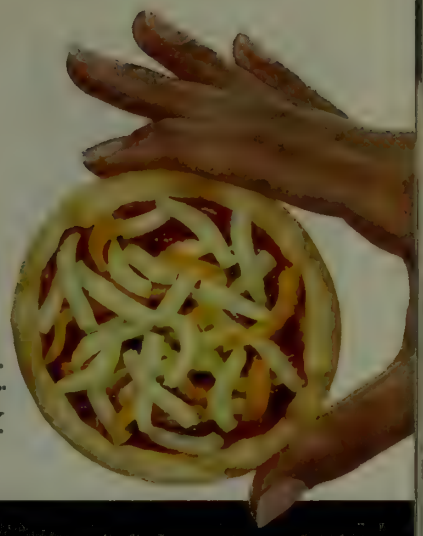
INA, INDIA—AND WHAT ERICA NEEDS TO DO NOW

"CHINA & INDIA: What you need to w now" (Cover Story, Aug. 22/29): As hinese student studying in the U.S., I nd that *BusinessWeek*'s special report wers a question that has haunted me a long time: What are the differences ween China and India in terms of economic development? India's long colonial tory and Western-style political, economic, and education system make it easier for the country to enter the international info-tech and financial-services markets. China, except for technology and management knowhow, never fully accepted or welcomed Western culture and values. Most Chinese students in the U.S., because of language and cultural barriers, have difficulty entering U.S. society.

After 15 or 20 years, India, with its growing U.S. and European ties, probably will be the largest service supplier behind most of the world's top companies. China, with knowledge brought back by foreign-educated Chinese students, will become a more independent figure in the global market.

–Jingjing Zhang
Atlanta

> "[Kraft's] supposedly healthy 'pizza de resistance' has 36 grams of sugar."
>
> *–C. Andrew Aligne, M.D.*
> *University of Rochester*
> *Rochester, N.Y.*



IS IT POSSIBLE that a historian in 2100 looking at the slide of the U.S. into second-tier-nation status will put your "Evangelical America" (Special Report, May 23) and your "China & India" next to each other and recognize what happened?

During both World War II and the Cold War, the U.S. had a reasonable balance between science and faith. In recent years, witness the collapse of proper funding for particle physics, the failure to have a legitimate replacement for the Hubble telescope, a space program likely to lose its way trying to send humans to Mars, a government that fears and underfunds microbiology, the start of a reverse brain drain of world-class scientists to Europe and Asia, and the emerging wreckage of science education in high schools—with folks eager to wreck it at the university level, too.

If the looming science gap isn't a clear and present danger to the well-being of the country, what is?

–Neil Lichtman
Naperville, Ill.

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Technology&You

BY STEPHEN H. WILDSTROM

Bait, Tackle, and GPS

Years ago when I used to sail a lot, the only electronic gear aboard most boats was a two-way radio and perhaps a depth sounder. The big fancy rig might have radar and finicky Loran position-finding gear. But with the electronics available on pleasure craft today, about the only way to get lost at sea is by watching satellite TV instead of charts on the cockpit display.

I recently spent a lovely late-summer morning on the Chesapeake Bay on a 31-ft. Contender sport-fishing boat loaded with the latest gear from Raymarine, formerly the marine electronics division of Raytheon. The biggest breakthrough is the integration of a variety of data—radar, sonar, electronic charts, satellite imagery—into one display. Sensors on the Contender fed information to a 12-in. Raymarine E120 cockpit liquid-crystal display that was bright enough to be read easily even in brilliant sunlight. Like anything involving boats, this gear isn't cheap. The E Series system with the 12-in. display costs $4,800 plus installation—not including the cost of individual sensors, such as the $780 digital sounder.

RAYMARINE E SERIES LCD FOR BOATS

For safety and convenience, the technology that offers the most to boaters is the global positioning satellite system. Many small boats make do with handheld GPS receivers to get coordinates that can be plotted on paper charts. But an integrated system adds real value, displaying your boat's position, speed, and heading on the chart and allowing easy identification of buoys and other aids to navigation. On a calm sunny day, the system is an interesting diversion; on a rough night or in fog, it can be a lifesaver, especially when combined with a radar plot that shows nearby craft on the same display. The newest bit of safety gear that can be added is a collision avoidance transponder, such as the SeaCAS SafePassage AIS ($1,250), which allows pleasure boats to see and be seen by commercial traffic in busy waterways.

PLEASURE BOATING IS ABOUT FUN, and there's no shortage of entertaining features available on marine electronics systems. Traditional marine charts show land mostly as a blank. The Raymarine E Series can superimpose Google Earth-style satellite images to give a 3-D view of the shore. This makes it a lot easier to identify what you are seeing, especially on a relatively featureless shoreline like the Chesapeake, though it really is not much help in navigation. If you put the cursor on a point of interest on land, you get a pop up that might include a dockside restaurant's phone number, so you can use your wireless phone to call for reservations. There is some risk that such a complicated display can be distracting; under most conditions, the best way to operate a boat safely is to keep your eyes on the water around you.

Boaters now don't have to give up their HBO or ESPN, even on the high seas. There's a satellite TV receiver that can send programming to multiple displays on the boat. The stabilized antenna stays locked to a satellite even as the boat rolls. You can also hook up video cameras to keep an eye on the engine room or other areas of the boat.

Boaters can get HBO and 3-D views of the shore

We didn't have much use for television on our open-deck fishing boat. But we did have a sophisticated sonar-based digital fish finder that gave a rendering of everything below the surface with enough resolution to display both schools of bait fish and individual game fish. An experienced operator can identify the species of fish and whether the bottom is sand, rock, or muck.

A marine electronics system whose price can easily run into five digits still has its limits. We spent a couple of hours casting jigs near Chesapeake Bay Bridge. The fish finder showed what our charter captain said were rockfish—the local name for striped bass—swimming below schools of bait. But seeing fish is not the same as catching them, and for all our electronics, we returned to the dock empty-handed. ■

E-mail: techandyou@businessweek.com

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BY JON FINE

Media, Marketing, and Advertising in the 21st Century

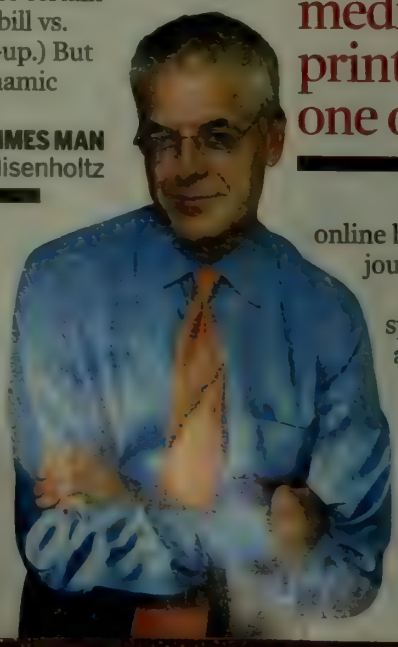
Is Paul Krugman Worth $49.95?

On Sept. 19, *The New York Times* rolls out the most ambitious attempt in years by a major newspaper to wring revenue from online readers. ¶ So we'll know soon whether the *Times* is very smart—or not very. ¶ With the debut of TimesSelect, 22 columnists will be available online only to those who ante up $49.95 a year and to the *Times*' 1.2 million subscribers. TimesSelect also includes archives back to 1980 (eventually, back to 1851), an early look at some of Sunday's non-news sections, and use of an online clipping service, TimesFile.

The big draw, though, is that columnists will engage in extracurricular activities with subscribers. John Tierney will oversee a book club and related discussions. Paul Krugman will host online classes pertaining to international finance, under the rubric "Money Talks." The sports columnists will gather for a twice-monthly chat. In "Everyone's a Critic," Frank Rich will post online observations and invite readers to debate sundry cultural topics, and Thomas L. Friedman will respond to reader mail. (*Times* execs wouldn't comment on how, or if, the columnists are compensated for extra work.)

TimesSelect targets the 1 million heavy users of nytimes.com who don't subscribe to the print edition, says Martin Nisenholtz, New York Times Co. senior vice-president of digital operations. "We are not expecting 10 million people to pay for it," he says. "We don't need to have them for the business model to work extremely well."

THAT'S GOOD, BECAUSE HE'S sailing into a stiff headwind. It's true consumers are willing to pay more for certain media offerings. (Consider today's cable bill vs. 1995's, or the costs of broadband vs. dial-up.) But one key market perversity is that this dynamic does not apply to print. Financial analysts find a growing dependence of leading papers—including the *Times*—on discounted subscriptions.



TIMES MAN Nisenholtz

And on the decade-old Web, "free" is the default setting, and it's difficult to make readers reboot. O.K., there's *The Wall Street Journal* (744,000 online paying customers and counting) and some targeted business sites. There are a few paid non-porn plays, like the *Milwaukee Journal Sentinel*'s Packers Insider. But in August, the *Atlanta Journal-Constitution* doubled back on a year-old attempt to establish a paid sports Web site. In May, the *Los Angeles Times* made its calendarlive.com entertainment section free again, following a two-year bid to charge $4.95 for monthly access.

It has proven next to impossible to get online users to pay for something that's not hard business data (which promises to make them money or keep them from losing it) or that doesn't play into fanatical tribal identification. While the *Times*' Maureen Dowd is a darling of her ideological set, political loyalties have not yet translated into the face-painting extremes of sports.

"Everyone is trying to figure out ways to start charging consumers" for online access, says one publishing exec, "especially in the newspaper business." The *Times*, like all papers, has struggled with this issue. It once toyed with charging for online access to certain Sunday sections, like the Book Review and magazine. The issue has become complicated as traffic at newspapers' free Web sites increasingly draws ad dollars. One reason columnists are an interesting platform for launching fee-based services, Nisenholtz says, is that they're not an area advertisers clamor for, thus making it easier to experiment. The downside: The *Times* might discover that not even its vaunted brand can cadge dollars from online readers—a stomach-turning prospect in an era when online behavior threatens print franchises and quality journalism still costs serious dollars.

> People will shell out for all sorts of media, but print isn't one of them

Any move the *Times* makes these days invites spitballs, and Nisenholtz is well accustomed to playing an aggressive defense. He dismisses doubters of the *Times*' online plans by invoking strong double-digit monthly revenue gains at the recently acquired consumer guides network, About.com—a much derided deal at the time. Of course, there's one difference between About.com and TimesSelect. About.com is free. ■

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The Barker Portfolio

BY ROBERT BARKER

A Flop for Martha's Investors

It's tempting still to treat Martha Stewart as a joke. Indeed, the gags keep coming: Martha's next book? *Doyenne on Ice*. Or, did you hear about the New Orleans Kmarts? Looters took everything except the Martha Stewart stuff. Yet as the omnimediatrix returns to the airwaves, for some people it's no laughing matter.

I say that on behalf of recent buyers of shares in the public company Stewart controls, Martha Stewart Living Omnimedia. From under $20 in May, MSO now is above $33 (chart). The latest propellant? Anticipation of Stewart's Sept. 21 prime-time debut in NBC's *The Apprentice: Martha Stewart*. It's sure to offer some laughs, as Stewart does her take on Donald Trumpian reality TV, sorting among 16 contestants who want to work for her. In a promotional video, Stewart promises: "Money can't buy what you're going to learn here." Maybe. But as usual, I'm focusing instead on the fine print.

MSO, WHICH STEWART directs via 91% of the voting shares, last year lost nearly $60 million on $187 million in revenue. Since March, however, when Stewart exited a federal penitentiary after serving five months for conspiracy, obstruction, and lying to investigators, the company has advanced on several fronts. Its flagship magazine, *Martha Stewart Living*, is enjoying nice gains in ad sales. MSO also is hopeful about a line of "how-to" DVDs, a satellite radio channel, plus a syndicated TV show starring Stewart that began Sept. 12.

Most of all, there's Martha's turn in prime time with *The Apprentice*. For investors, unfortunately, it comes with a catch. Even if the show is a smash, MSO stands to gain only indirectly. As its filings put it, "While MSO will not have a direct financial ownership interest in the prime-time program, MSO expects to benefit from promotion of the Company's brands, products and its businesses. We expect that this program will expose the brand to a wider audience of viewers, consumers and business partners." Yet I wonder: How many will see Martha Stewart as a fresh face? The company told me that it's pleased with the cross-promotional revenues *The Apprentice* is generating for MSO's own print, syndicated-TV, and online ventures. Are those revenues big enough to prove financially meaningful? MSO declined to say.

APPRENTICING Stewart and Trump at a promo shoot

If the extent of those benefits is unknown, the costs are not. In 2004, MSO signed a broad consulting deal with *Apprentice* producer Mark Burnett. His end included helping MSO create its new syndicated TV show plus a prime-time program. In return, MSO gave Burnett a warrant to buy 2.5 million shares of stock, which vest in three parts. In the second quarter, as plans for MSO's daily show jelled, Burnett's first slice vested. Cost to MSO: $16.8 million. Now, with *The Apprentice*, the second part is vesting. And as MSO's stock rises, so does the cost of Burnett's shares, since it's reckoned on the vesting dates. The final tab of his *Apprentice*-linked shares is a moving target, but recent stock prices indicate $20 million to $22 million.

This is a noncash expense, yet for a company that netted a first-half loss of nearly $53 million on $85 million in sales, it's out of whack. Meredith, publisher of such rival magazines as *Better Homes & Gardens*, has six times MSO's revenues. It spent an annual average of $11 million over the past three years on all of its stock-based pay. Nor does the cost of *The Apprentice* to MSO end with Burnett. Stewart gets her own cut—in cash. For each *Apprentice* edition she winds up on, MSO will pay her at least $500,000. This is atop her annual $900,000 salary as MSO's founder, annual bonus of $495,000 to $1.35 million, and a $200,000 signing bonus for agreeing to go on the air. Beyond usual reimbursement of business expenses, MSO is giving her $100,000 a year as a "non-accountable expense allowance." Add it all up. The only laugh you'll hear is Martha's. ■

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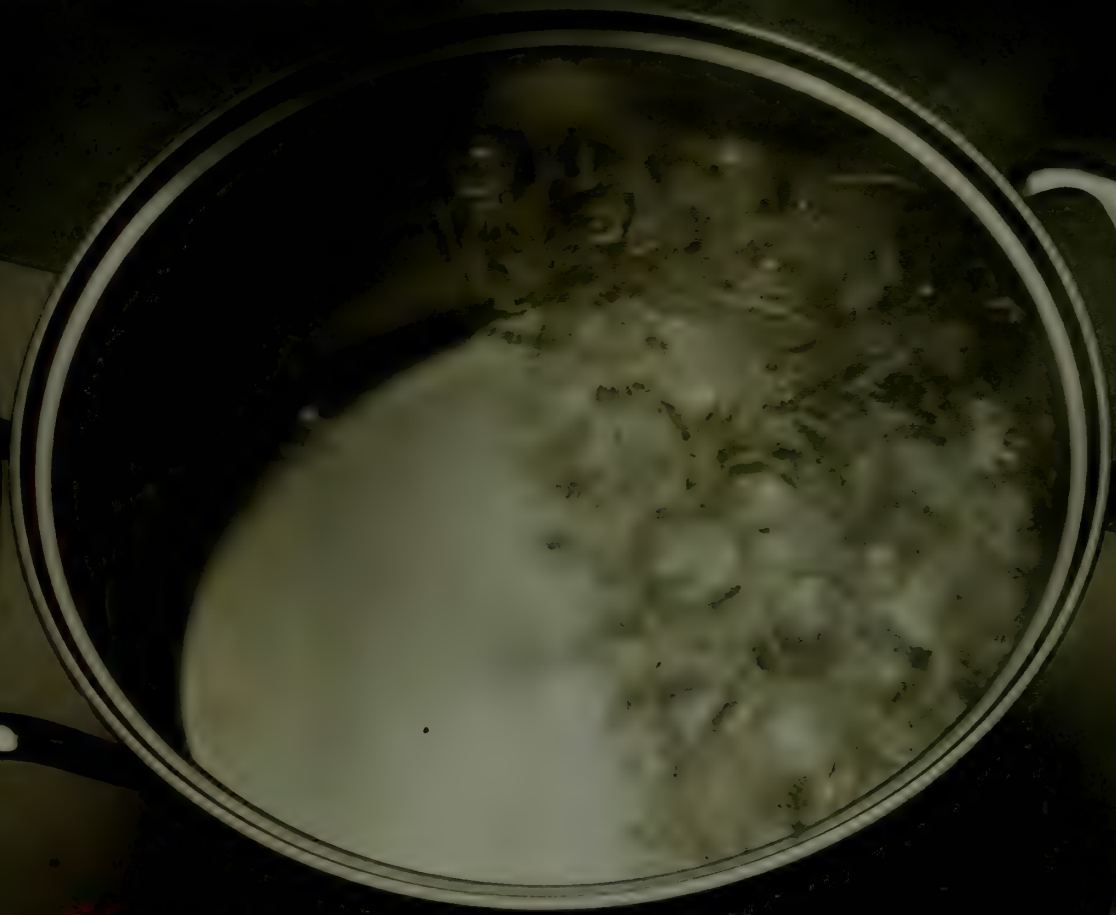

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JAMES C. COOPER & KATHLEEN MADIGAN

Katrina Will Force Hard Choices

ebuilding costs and planned tax relief could swell the deficit

U.S. ECONOMY In coming weeks, Congress will begin to allocate nds to rebuild the areas devastated by Hurricane Katrina. At the me time, the Bush Administration remains dedicated to reforming e tax code and making permanent the 2001-03 tax cuts at a cost of 1.85 trillion, even as it budgets for a newly enacted $286 billion

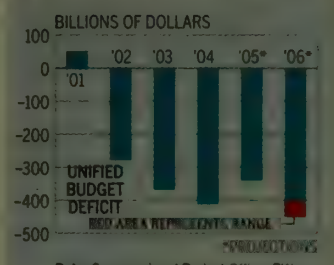
nsportation bill and the wars in Afghanistan and Iraq. In this case of levee vs. levy, it looks as if the dams have n—at least for now. On Sept. 12, the Senate leadership t off a vote on the 2006 budget reconciliation bill. That ludes delaying some actions on tax relief in deference emergency spending plans. It has postponed plans to end tax cuts on capital gains and dividends, currently eduled to expire in 2008. It has tabled voting on ealing the estate tax, along with a $35 billion package spending cuts to Medicaid and other entitlements. Still, the moves appear to have been made more out of itical motives than fiscal prudence. Since the tax cuts n't expire for a few years, there's plenty of time for ngress to take up the issue later on. House leaders have eady vowed to bring a $70 billion tax-cut measure up a vote. And Treasury Secretary John W. Snow said on ot. 13, "Now is not the time to increase the tax rden"—while also promising that the White House uld halve the deficit by 2009.

However, officials on both sides of the aisle are starting wonder how cutting taxes and whittling away the icit can be achieved in light of the massive bill for trina; some congressmen have estimated that the final could hit $200 billion.

READY, ECONOMISTS are raising their deficit forecasts fiscal 2006, which begins on Oct. 1. Before Katrina, the ngressional Budget Office had projected the 2006 red to total $314 billion. Now, some private economists nk next year's deficit will surpass the record of $412 ion set in 2004 (chart), putting the deficit as a percent gross domestic product in the range of 3% to 3.5%. Massive amounts of red ink threaten to create a dgetary conflict that will affect the economic outlook 2006 and beyond. Congress may finally have to face rd choices regarding spending. And the White House y have to accept that it cannot pay for Katrina and ange the tax code in the sweeping ways it had hoped, ile paying for huge initiatives on Social Security and edicare. At least, that can't be done without risking gative reactions from the financial markets and adverse nsequences to the economy.

Deficits do matter. The trend in government finances can stimulate or subtract from economic growth. Higher government borrowings can draw money away from private projects. This "crowding out" of private investment can raise interest rates for all borrowers, including home buyers. Meanwhile, fiscal stimulus is set to pump up growth just as Federal Reserve officials are trying to keep a lid on overall demand growth and inflation.

THE FEDERAL DEFICIT IS SET TO GROW AGAIN



Data: Congressional Budget Office, *BW*

Currently, the government's relief effort is adding about $2 billion a day to the economy. Given the rapid approval of federal relief funds, the rebuilding of Louisiana, Mississippi, and Alabama could quickly offset the drag coming from job losses and business closings in the area.

For example, the initial $62.3 billion in aid (page 53) is set to be paid out by early October. If that money is spent over the next three months, it will add some 2 percentage points to overall growth in U.S. real GDP, spread over the third and fourth quarters. And there is speculation that the Administration will ask for an additional $50 billion soon.

BY EARLY 2006, stimulus from rebuilding should be kicking in. The CBO estimates that each set of 100,000 homes rebuilt will add 0.2 points to GDP growth. Then there's the unestimated loss of business and public structures that will be replaced using insurance payouts or government aid.

Bear in mind that this fiscal stimulus will be added to an economy that was doing very well before Katrina. The August data show that while overall retail sales dropped 2.3%, non-auto sales were up 0.5%, even excluding higher-priced gasoline. Industrial production in the factory sector increased 0.3% last month. And in July, the trade deficit narrowed to $57.9 billion, from $59.5 billion in June, a surprise plus for third-quarter GDP growth.

To be sure, higher energy prices are shifting money

away from spending on other items. But the latest data show national gasoline prices dipped to $2.96 per gallon on Sept. 12, from the record $3.07 a week earlier, after most refineries hit by Katrina came back online. And with the futures price of gasoline for October delivery now below its pre-hurricane level, further declines at the pump are on the way (chart).

SURGING OUTLAYS for post-hurricane relief and rebuilding and their deficit implications will complicate Fed decision-making on monetary policy, both in the short run and further down the road. Most immediately, the Fed meets on Sept. 20 to decide whether to raise its target interest rate by another quarter point, to 3.75%.

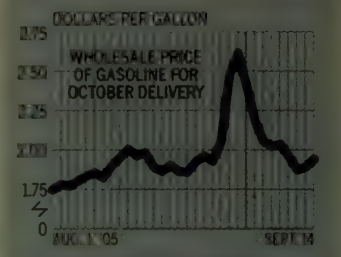
Some observers are expecting the Fed to pause in its rate-hiking pattern at that meeting, while others expect a pause later on. Even if the Fed hikes on Sept. 20, analysts will dissect the post-meeting rate announcement for hints of what could possibly trigger the Fed to pause at either its Nov. 1 or Dec. 13 meetings.

But given that the new burst of spending will add to the economy's momentum, the Fed will have to weigh the risk that pausing could heighten inflation pressures in 2006, vs. concerns about possible economic weakness coming from Katrina uncertainty and high fuel bills.

Rising energy costs already threaten to filter their way into higher prices for other items, even as tighter labor markets begin to push up labor costs. Later on, as deficits grow even larger, the red ink will require funding, possibly at the expense of higher interest rates that could thwart private-sector investment and rob the economy of some long-run growth potential.

On the fiscal side of economic policy, budget makers must deal with the notion that, while allowing the tax cuts enacted in 2003 to expire would improve the deficit outlook, it would also slam the economy.

PUMP PRICES ARE SET TO FALL FURTHER



Data: Bloomberg Financial Markets

In particular, the financial markets have already priced in the Administration's planned extension of the tax cuts for capital gains and dividends. If they are not extended, it would likely be a blow to stock prices. Plus, companies planning to expand their dividend programs, which would be a plus for personal income, might reconsider. Likewise, not extending the fix to the alternative minimum tax set to expire at yearend would be a $30 billion tax hike on households. And there is the long-run need to shore up Medicare and Social Security funds before the Baby Boom generation retires.

The rebuilding required by Katrina highlights a critical problem Washington has created by running massive deficits year after year. There is no fiscal cushion when a disaster demands a government response. Compassion may be priceless, but it is not without costs. ■

CENTRAL EUROPE

What's Delaying the Euro

MOMENTUM IN Central Europe to adopt the euro as soon as possible has diminished. Low interest rates and upcoming elections are proving to be disincentives. As a result, it's unlikely that Hungary, Poland, and the Czech Republic will be switching to the euro by decade's end.

On Sept. 10, Hungary's central bank president, Zsigmond Jarai, said he was doubtful that the country would adopt the euro by 2010. And just days earlier, the Czech government pushed back its official currency adoption target from 2009 to 2010. The big obstacle is budget deficits. Currently, the three largest Central European economies, as well as Slovakia, are running shortfalls above the 3% of gross domestic product limit mandated by the European Union's Maastricht Treaty. Deficits in all four countries are also expected to top the 3% level in 2006.

DEFICITS REMAIN TOO LARGE

PERCENT OF GDP

	2004	2005*	2006*
CZECH REPUBLIC	3.0%	4.5%	4.0%
HUNGARY	4.5	3.9	4.1
POLAND	4.8	[illegible]	3.8
SLOVAKIA	3.3	[illegible]	[illegible]

Data: European Commission

Efforts by the region's central banks to align their respective short-term interest rates with the European Central Bank may be slowing down the process. All four countries have trimmed rates to approach the ECB's current 2% level. The moves reduce the cost of budget deficits. In addition, currency appreciation against the euro makes fiscal borrowing in euros even more attractive. That's especially true for Hungary, where the two-week deposit rate is 6.25%.

Elections will also hamper progress. Poland holds parliamentary elections on Sept. 25. The other three nations are scheduled to hold national elections in 2006. Economic reforms will be put aside for the time being and spending could actually loosen beforehand: Poland's government scrapped plans to end early retirement benefits for miners in August. Immediately following elections, the new governments are expected to rein in deficits, but there are also hopes that taxes will be trimmed.

A delayed euro adoption means continued currency volatility. Big fluctuations, especially on the upside, can hurt economic performance by making exports less attractive and imports cheaper. Nonetheless, analysts believe only Slovakia has a shot at adopting the euro by 2010. For the rest of the pack, 2012 looks more probable. ■

–By James Mehring in New York

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MERGERS & ACQUISITIONS

TECH DEALS: BACK WITH A VENGEANCE

As mature Silicon Valley companies team up, others are racing to corner sizzling new markets

BY JOSEPH WEBER AND ROBERT D. HOF

IT ALL HAS A VAGUELY FAMILIAR feel: eBay Inc. ponies up $2.6 billion to purchase Internet-phone upstart Skype Technologies, a company that so far seems to be more about buzz than the bottom line. Then, an hour and a half later, Oracle Corp. announces a $5.85 billion deal for rival Siebel Systems Inc. Suddenly it seems Silicon Valley dealmakers, laid low by the Internet bust five years ago, are riding high again. And the betting is that there will be plenty more deals splashed across headlines before the year is out.

Indeed, the tech realm already accounts for a growing piece of a surging deal arena. Back in the bubble days, U.S. tech deals accounted for some 21% of total mergers and acquisitions, a staggering $358 billion worth, according to Thomson Financial. With the high-tech bust, that share plunged into the low single digits by 2002, but it has risen again and now accounts for about 10%—or some $70 billion worth—of announced deals. Most striking, the money spent on $1 billion-plus U.S. tech deals has quadrupled in the past year, to $38 billion. "This is going to be the biggest year for tech deals since 2000," says Thomson market strategist Richard Peterson.

Yet the current wave of dealmaking is nothing like those wacky deals of tech-bubble lore when companies readily plunked down billions on skimpy business plans and unproven ideas. Whereas the 1990s tech industry resembled a bunch of passionate teenagers in a hurry to pair off, today's deals often look a lot more like sensible marriages. Says Karl Will, head of tech mergers for JPMorgan Chase & Co.: "What you're seeing is classic maturation, where eventually there will be one or two major players in each tech subsector."

HEAD-SCRATCHING

BUT THAT ONLY partly explains what's happening. Even as the leaders in sectors such as software consolidate, others are racing to stake out a position in hot new growth areas such as Internet telephony, paid search, and wireless services. The urgency to play in these fields helps explain the big price eBay was willing to pay, even if the auction giant's strategy of building a broader e-commerce business through Skype has caused head-scratching throughout Silicon Valley.

It also explains a host of other recent tech deals, mostly involving Net-related

SO IN THIS SECTION:

6 Yahoo: Growing image problems?

38 It's open season on Big Oil

42 The mother of all toxic cleanups

49 How the airlines stay aloft

Many of high tech's giants–the likes of Google, Oracle, Verizon, and eBay–are on an empire-building tear

services or content. Among them: InterActiveCorp's buy of search engine Ask Jeeves for $1.85 billion, New York Times' purchase of Internet guide service About.com for $410 million, and News Corp.'s acquisition of video-streaming service IGN Entertainment and myspace.com, the social-networking site, for a combined $1.3 billion.

Greasing the dealmaking skids are record levels of corporate cash. Microsoft with $37.8 billion, Intel with $12.6 billion, Dell with $9 billion, and IBM with $8.7 billion all have cash to burn, should they decide to do so. Private-equity firms are also awash with resources. Kohlberg Kravis Roberts & Co. and Silver Lake Partners, for instance, were buyers in both the August $2.66 billion deal for the semiconductor unit of Agilent Technologies Inc. and the earlier $11.4 billion purchase of SunGard Data Systems. Such private buyers "have awfully big ambitions and the financing markets today are accommodating them," says Jack Levy, head of global M&A at Goldman, Sachs & Co.

With many tech sectors maturing, consolidation will be the name of the game. Just look at telecom in the past year: SBC Communications snatched up AT&T, and Verizon snared MCI. Lenovo's buy of IBM's PC unit falls into much the same camp: Some now think the combined company could scoop up struggling Gateway.

For Oracle, the Siebel deal is just the latest in a series of purchases, with an estimated value of more than $17 billion, orchestrated by CEO Larry Ellison over the past 10 months. His goal: to beef up Oracle's business-software offerings in the face of a maturing industry and a shift by corporate buyers toward one-stop shopping. Ellison's frenzied dealmaking has many in the industry wondering if Oracle can digest it all, but so far, it seems to be working. Its 2004 deal for PeopleSoft is already bearing fruit. When Oracle announced its fiscal fourth quarter in June, revenues in the key business-software-applications market shot up 52%. That leads many to believe the PeopleSoft integration has gone smoothly.

FRESH FOOTHOLDS

AFTER SNAPPING UP PeopleSoft, Retek, and a clutch of smaller targets, Ellison figures the new deal will help him face off off against German business-software titan SAP. It also gives Oracle a foothold in areas where it was weak. Siebel, for instance, is a potent force in serving financial services and telecom companies, unlike both Oracle and SAP. Siebel is also the technology leader in customer-relations management software, a field where Oracle has lagged behind. So Oracle will be able to pitch a bigger base of customers on a fuller array of products. Still, competitors snipe that dealmaking can get Ellison only so far. Says SAP CEO Henning Kagermann: "He says he wants to be closer to No. 1. But how can he become No. 1 when there are no other major acquisition targets left anymore?"

The purchase of Skype is a different story altogether. The Internet is in the midst of a new mini-boom. And with cash-rich Internet pioneers eager to stay on their growth trajectory, they're grabbing upstarts in hot new segments with abandon. In recent months, Yahoo swallowed photo-sharing site Flickr and Internet-phone start-up Dialpad, while Google collected mobile-services startup Dodgeball and wireless-phone software company Android. Last year, eBay pocketed comparison-shopping site Shopping.com and home-rental site Rent.com. In much the same way, the Technorati blog search firm could be a promising target for a buyer such as Microsoft, while Facebook, the college-student social networking site, could appeal to a Net-savvy outfit such as News Corp.

EBay is betting that Skype will plug the big online-auction company into several new revenue sources. For one, sellers who use eBay's auction site and tack a "Skype Me" button on their listings would pay eBay a fee every time someone clicks through and connects via Skype—a business eBay thinks can eventually generate $3.5 billion. And venues, such as eBay's

Where the Deals Are

2005 Tech Sector Mergers & Acquistions*

SECTOR	NUMBER OF DEALS	VALUE OF DEALS (BILLIONS)
SERVICES	11	$21.6
SOFTWARE	23	14.3
HARDWARE	10	7.9
NETWORKING AND TELECOMMUNICATIONS	7	5.4
INTERNET (SERVICES, MEDIA, GAMES)	7	5.3
DEFENSE	3	3.3
SEMICONDUCTORS	5	3.2

*Top 66 deals announced through Sept 12
Data: Thompson Financial, *BusinessWeek*

Who's Next?

As tech deals heat up, prospects in both maturing markets and fast-growing fields are getting a lookover. Who could be bought—and who might buy:

COMPANY/MARKET CAP	WHY IT'S A TARGET	POTENTIAL ACQUIRERS
Computer Associates $16.5 billion	Despite countless software acquisitions, growth has stalled	Hewlett-Packard
BEA Systems $3.6 billion	Supplier of infrastructure software is squeezed between IBM and upstarts	SAP, Hewlett-Packard, Sun Microsystems
Salesforce.com $2.5 billion	Hot supplier of online customer-management software could give acquirer a jump on rivals	Microsoft, SAP
CNET Networks $2 billion	The online publisher has popular news, games, and reviews, a lure to Internet and traditional media alike	Yahoo!, News Corp.
Gateway $995 million	Beaten by Dell, the restructured computer maker hasn't proven it can regain market share	Acer, Lenovo
TiVo $429 million	The popular DVR service has lost $658 million since 1990 and faces stiff new competition	Comcast, Time Warner, SBC, Verizon, Microsoft, Philips
T-Mobile USA N/A	A national carrier, but could be too small to weather the wireless shakeout	Comcast, Time Warner
Technorati N/A (private)	The leading Weblog search engine could be a plum for media companies moving online	InterActiveCorp, America Online, Microsoft
Facebook N/A (private)	A social-networking site popular with college kids that would fill out media companies' online portfolios	News Corp., InterActiveCorp

wly created Kijiji international classi-
l-ad site, could generate revenue from
h leads. Finally, eBay figures Skype's
e business in Internet phone commu-
ations will be a moneymaker. Skype
nects people computer-to-computer
free, but charges for linking PCs to
ones and voice mail. On tap: fresh
vices such as videoconferencing.

'E THOUGHT HARD"

YPE IS RACKING UP sharp growth, but
y a modest payoff. The Luxembourg
fit garnered $7 million in revenues last
r and says it is on track to hit $60 mil-
n this year and $200 million in 2006. By
end of September, it expects to count
million customers. "We thought hard
out stepping out into the communica-
ns space," says eBay Chief Financial Of-
r Rajiv Dutta. "But assets like this don't
ne up for play so often."

That gamble is hardly
eap. The deal's initial price
—$1.3 billion in cash and
same amount in stock—will
w to $4.1 billion if Skype
ches certain performance
als by 2009. That's a lot of
ney for a company that isn't
ected to reach breakeven
il late 2006.

Still, it's money eBay execs
m happy to pay. "The reality
here's less risk in the Inter-
today, so it's appropriate
t prices are higher," says
tta. With both the technolo-
and the business models of
ernet powerhouses such as eBay and
ogle Inc. proven quantities now, deal
osters say, emerging Net companies
y inevitably command higher prices.

Of course, there are still plenty of skep-
s out there. When news of the Skype
al broke, "I had to check my calendar to
that it was 2005 and not 1999 or
00," jokes Peter Falvey, managing di-
tor of the Boston investment banking
utique Revolution Partners. Falvey is
ong a growing chorus of critics who
rry that the Skype deal smacks a little
much of the frenzied dealmaking and
y thinking of the late 1990s.

But who knows? Maybe this time
ound, all those folks so eager to put
ir money to work in tech deals have
t it right. Either way, there's no doubt
t a lot more deals are coming down
e pike. ■

–With Sarah Lacy in San Mateo, Calif., Emily Thornton and Roben Farzad in New York, Andy Reinhardt in Paris, and bureau reports

THE INTERNET

Skype: How a Startup Harnessed the Hoopla

The buzz began building this summer. In June, reports surfaced that Yahoo! was in merger talks with Skype Technologies, the Internet-telephone company. Before long, rumors were circulating that News Corp. and Google, too, were interested in Skype. In the end, the acquirer was perhaps the least likely suitor of all: eBay Inc., which announced on Sept. 12 that it would pay $2.6 billion in cash and stock for the Luxembourg outfit, with a further $1.5 billion to come by 2009 if Skype hits key performance targets.

ZENNSTROM AND FRIIS Good timing and salesmanship

How did Skype, founded just three years ago, manage to parlay itself into that kind of prize? Sure, it has 54 million users hooked on its free phone service. But with revenues expected to hit just $60 million this year and break-even not likely until late 2006 even should Skype's rapid subscriber growth continue, the price astonished many observers. Good timing is part of the answer, given the huge appetite among media and Web companies for an Internet-telephony play. At the same time, Skype and its advisers proved themselves to be master salesmen.

Skype's founders insist that they never set out to pump up the company and flip it for a quick profit. "Our objective was to build the business," says Niklas Zennström, who, along with co-founder Janus Friis, also started the free music-downloading service KaZaA. As Skype began to take off last year, says Zennström, it started looking for partnerships with other Internet companies to help broaden its distribution. Shortly thereafter, Zennström and Friis began meeting with Yahoo!, Google, Microsoft, and others.

None of those discussions came close to a deal, say sources close to Skype, but by this summer, all the buzz had attracted the attention of the world's most powerful media tycoon, Rupert Murdoch. In June, Skype's top dogs sat down in London with the News Corp. chief, who was considering buying a 20% stake in Skype as part of his new Internet push. People with knowledge of the meetings say Murdoch was impressed with Zennström, but the two couldn't agree on price.

With potential suitors buzzing around, Zennström and Friis began to consider selling the whole company. Skype hired a Morgan Stanley team from London to help it explore strategic options. Then in late July, Timothy C. Draper, whose Menlo Park (Calif.) venture-capital firm, Draper Fisher Jurvetson, is one of Skype's biggest investors, put the world on notice that Skype wouldn't go cheap: Anyone who wanted to acquire the company would have to shell out a minimum of $1 billion.

By then, eBay and Skype had been quietly talking on and off for nearly three months. When Zennström and Friis first met eBay CEO Margaret C. Whitman in May in London, both sides felt they had little in common. "But when we started talking, we had an Aha! experience," Zennström recalls. "We went crazy on the whiteboard, mapping out ideas."

At first, their discussion focused on partnership. But before long a larger deal took shape. By merging with eBay, Skype could get what it had sought all along: a big parent that could widely distribute its product. EBay, in turn, would gain a fast-growing young business to supplement its core e-commerce business. All that was left to work out was a price—one that would meet Skype's lofty expectations. And by Sept. 12, they had that, too.

–By Justin Hibbard in San Mateo, Calif., with Andy Reinhardt in Paris, Tom Lowry in New York, and bureau reports

COMMENTARY

BY BEN ELGIN

For Yahoo, Mistrust is Popping Up

Its hands are tied in China, but the portal could do more to fix adware problems

YAHOO! INC. HAS been taking a beating in the blogosphere lately. On Sept. 6 came the revelation that it provided information that helped Beijing jail a journalist. Days earlier, a report said Yahoo was actively supporting the companies that spawn pop-up ads. Around the same time, bloggers started griping about new Yahoo software downloads that change the preferences on users' PCs. Pretty soon, even a Yahoo employee was blogging about it. In early September, Yahoo engineer Jeremy D. Zawodny sounded off on his blog: "Do I like those [software installation] practices? Hell no. It's insulting and disrespectful."

Looks like Yahoo chief Terry S. Semel faces a potential problem. Sure, no one issue will turn off Yahoo users in droves. But add them up, and Yahoo risks tarnishing its reputation as a trustworthy Net player, even as rival Google Inc. holds itself up as a paragon of consumer friendliness. Trust is critical in the online world, where consumers are asked to hand over their most sensitive information and communications. Warns Forrester Research Inc. analyst Charlene Li: "Enough of these pinpricks could hurt Yahoo's image."

Yahoo Chief Operating Officer Daniel L. Rosensweig insists the company has the highest standards. "Users can put their trust in us because that is what we're built on," he says.

The most damning gripe about Yahoo concerns its involvement in the controversial adware biz. Adware is downloaded onto PCs—often without a user's consent—and spawns pop-ups based on where the user goes online. Yahoo has been criticized for cutting deals with adware companies wherein ads by Yahoo clients appear in pop-ups; Yahoo then splits the revenue with the adware outfits.

The controversy flared anew on Aug. 31, when a report indicated that Yahoo continues to work closely with these companies. The report's author, Ben Edelman, an adware researcher and consultant, also noted that Yahoo is struggling to control which adware outfits showcase its clients' ads. His research shows Yahoo's ads are far more likely to surface in unwanted pop-ups than were Google's. That's the last thing an image-conscious Net outfit needs.

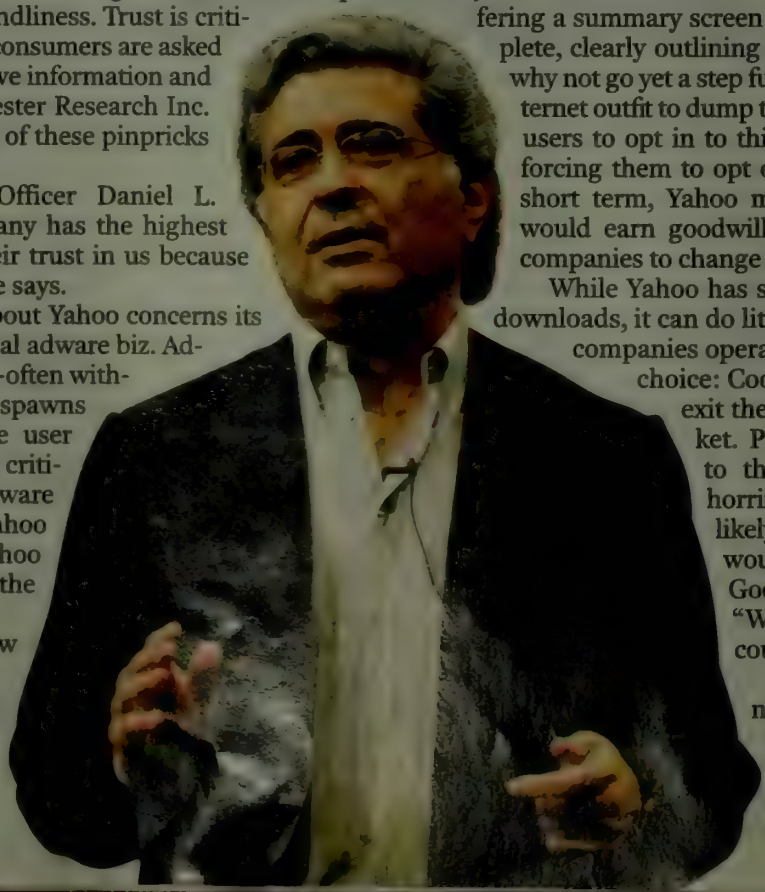
To Yahoo's credit, it is leading industrywide discussions aimed at devising new practices for the adware companies. Yahoo also insists it does business only with adware companies that adhere to best practices and that its ongoing involvement in the industry has already boosted standards.

Since Yahoo says it's serious about reforming the adware industry, why not take the lead in another much-griped about area: the widespread practice of forcing users to opt out from software downloads they didn't want in the first place. The company was blasted earlier this month when bloggers discovered that users downloading its instant messenger received other Yahoo products or found their default search pages changed to Yahoo if they didn't specifically opt out of those choices.

Yes, Yahoo is far from alone in this. And it bests rivals by offering a summary screen before the installation is complete, clearly outlining what the user is getting. Still, why not go yet a step further and be the only major Internet outfit to dump those pre-checked boxes? Allow users to opt in to things they do want rather than forcing them to opt out of those they don't. In the short term, Yahoo may lose some visitors, but it would earn goodwill—and potentially force other companies to change their practices, too.

While Yahoo has some control over adware and downloads, it can do little about the flap in China. All companies operating there face the same stark choice: Cooperate with the authorities or exit the world's fastest-growing market. Providing information leading to the conviction of a journalist horrifies many people, but it's unlikely that Yahoo's biggest rival would do anything different. As a Google spokesperson admitted: "We adhere to the laws of the countries in which we operate."

Still, Yahoo's black eye in China probably won't be the last. All the more reason to keep its reputation spick-and-span everywhere else. ■



SEMEL Yahoo could set an example for other sites

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ENERGY

OPEN SEASON ON BIG OIL

An angry public wants quick relief from high prices. Here's why none is in sight

JOHN BROWNE, THE CHIEF executive of BP PLC, the largest producer of oil and gas in the U.S., is already spending $14.5 billion this year on exploration and production and other capital projects, and he would like to do even more. "Could we expand our investment upstream?" he says in an interview in his office overlooking London's St. James's Square. "The answer is we have plenty of opportunities to do that. But we can't find the rigs, the service contracting, all the things we need to get it done."

For instance, Browne wants to rapidly expand BP's Rocky Mountain gas project in Wamsutter, Wyo. But BP can't find enough drilling rigs for hire, so it's having new ones built. That, however, will take about a year. Browne and other top oil executives are in an awkward position: They're feeling beleaguered even as they head toward record profits this year—some $118 billion for the 10 of the largest companies, according to A.G. Edwards & Sons Inc. Even while the companies' costs are soaring as they scramble to secure more oil and gas, politicians from Senator Hillary Clinton (D-N.Y.) to French Finance Minister Thierry Breton are taking aim at them in response to consumers' growing fury over skyrocketing prices at the pump. France's Breton threatened a windfa profit tax if oil companies don't imme ately cut prices of refined produ whenever the price of crude goes dow In Washington, pols—mostly Democra no longer in power—are proposing e cess-profit taxes and higher subsidies f renewable fuels. House Democrat Leader Nancy Pelosi also wants to gi the Federal Trade Commission authori to prosecute oil companies for pri gouging. "The fact that oil compani are enjoying record profits when co sumers are paying record high pric does not sit well with people," sa Tyson Slocum, research director of t pro-consumer group Public Citizen.

What can Big Oil do to defuse t anger? The best possible course of actio is to pump more oil, refine more gas line, and bring prices down to levels th won't spook investors and markets. B the best solution is not the likelies There's no way the oil majors can floo the markets, for the simple reason that takes years to find the oil, build t refineries, and construct the pipelin that will turn a shortage into a surplu The spending is now surging. But n quick relief is in sight, as new playe like China drive up demand and dearth of refineries globally sends gas line prices skyrocketing.

How did this happen? A mix of mi

ICE SHOCK Royal
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steps—and a series of events beyond even the control of the oil giants. In some respects the oil companies have made their own bed. In the late 1990s, as prices sank to a low of close to $10 per barrel, they played to Wall Street, slashing veteran exploration and production staffers and gobbling each other up through acquisitions, often instead of drilling for new oil.

All this has led to a lean industry that has delivered strong financial results, but roller-coaster pricing for consumers. It the penny-pinching of the past that s led to a shrunken drilling and refin- y sector. Skilled workers are no longer ound to make the steel that goes into ilding new rigs, man them, and more. "The industry has not been an attrac- e place for people to work," says owne. With demand surging, this arth of equipment and talent has led to doubling of day rates for drilling rigs in e past 18 months—to $200,000 for siz- le offshore rigs and as much as 400,000 for jumbos. Managing the in- stry for quarterly results has been less an ideal for an oil-thirsty world.

Meanwhile, the majors failed to anticipate the surge in global demand that has overtaken the industry. For much of the recent past, demand grew only 1.5% a year—until 2004, when it jumped almost 4%. Even early last year demand forecasts from energy watchers were pessimistic. With predictions way off, the industry didn't prepare for the explosion in consumption. "The reason why these problems are hitting us now is that we have exhausted the spare capacity that kept us going for 20 years," says Jeffrey R. Currie, a Goldman, Sachs & Co. analyst in London. "We need to tap new capital for greenfield projects in more hostile political and geological environments."

Executives need to make multibillion investment decisions without knowing whether oil prices are going to keep rising or plunge to the $20 range that prevailed through the 1990s and inched up gradually until 2004. Now companies are slowly increasing their pricing assumptions. Browne says BP figures prices will remain around $40 per barrel for the next five years. But the industry's leaders, who rose up the ranks in the relatively lean times of the '90s, are still being conservative—some think obstinately so. No oil executive will cut a deal for five years out assuming that today's spot price of $65 will prevail.

The majors failed to anticipate the surge in global oil demand

A SAUDI GLUT?

DESPITE THE RISKS, oil companies have boosted exploration substantially. Norwalk (Conn.)-based consultants John S. Herold Inc. report that 200 oil companies have roughly doubled exploration spending to a combined $180 billion for this year. "They're certainly spending a lot more. Whether or not they are spending enough, that's up for some debate," says research director Nicholas Cacchione.

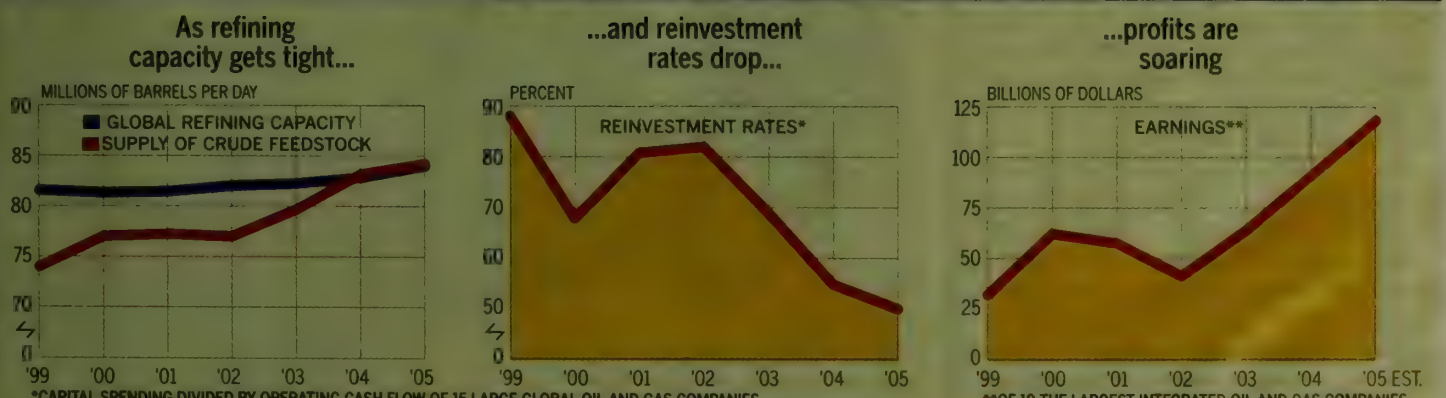
But while they explore more for oil, the oil is harder to find. Companies are being forced to replace their depleted sources of oil and gas in the West with new supplies in politically and geologically more challenging areas, from Russia to the deep water off West Africa. "The companies are making more money, but they have more risks," says J. Robinson West, chairman of Washington-based consultants PFC Energy.

Adding to the tension, the rate at which reserves are replaced is falling, and the production of four of the top five companies—ExxonMobil, Total, Chevron, and Royal Dutch/Shell Group—declined in the first half of 2005 vs. a year earlier, according to PFC Energy. The major oil companies have lost clout to host governments such as Saudi Arabia and Iran and their national oil companies, which now control 78% of global reserves.

Another uncertainty is the size of reserves in Persian Gulf countries such as Saudi Arabia. While much has been made about the prospect of the Saudis running out of oil, Currie says the more nightmarish scenario for the oil industry is that the Saudis, who have hired some 70 international drilling rigs for a 2.5 million barrel-per-day expansion—a boost the size of a key producer like Kuwait—will turn out to have plenty of crude, eventually driving prices down.

Even promising projects are becoming harder to pull off—a reality underlined this summer when Royal Dutch/Shell es-

OIL COMPANIES UNDER FIRE



*CAPITAL SPENDING DIVIDED BY OPERATING CASH FLOW OF 15 LARGE GLOBAL OIL AND GAS COMPANIES

**OF 10 THE LARGEST INTEGRATED OIL AND GAS COMPANIES

Data: Goldman Sachs Commodity Research, International Energy Agency (IEA); A.G. Edwards & Sons

timated that its Sakhalin II gas project in Russia would wind up costing $20 billion, double earlier forecasts. "The projects are in a variety of political environments," says Peter J. Robertson, vice-chairman of Chevron. "And they are technically more complex."

As a result, companies aren't getting as big a return on the money they do spend. The cost of finding new reserves has soared from $4.94 a barrel in 2000 to $8.61 today as prices for everything from rigs to steel pipe have jumped. For each dollar of price above $25 a barrel, Russia now takes 89¢ in taxes, up from 68¢ per dollar per barrel in 2003. Companies say these levies deter costly, risky investments.

BIG PLANS IN TEXAS

FOR SIMILAR REASONS, oil companies are also leery of investing in refining. No new refineries have been built in the U.S. since 1976, because of a combination of regulatory hurdles and local opposition. And the majors still see refining as a poor business, although profits on refining are now very lucrative at $20 per barrel, vs. under $5 per barrel as recently as the fourth quarter of 2004. That's why Arizona Clean Fuels, a startup that is looking to build a new $3 billion refinery in remote Yuma, Ariz., still hasn't lined up financing after 10 years of making plans and seeking permits. "The fundamental problem has always been economics," says CEO Glenn McGinnis.

That may be starting to change. Motiva Enterprises LLC, a joint venture between Royal Dutch Shell Group and Saudi Aramco, Saudi Arabia's state-owned oil company, is considering long-term capacity additions at its three Gulf Coast refineries, according to spokesperson Stan Mays. This development could be huge, says Edward Murphy, group director for refining and marketing at the American Petroleum Institute, an industry trade group. "I think we're past the point of asking 'What do we need to do to see more expansion?' The incentives are there right now."

That's encouraging. But such projects take years to come to fruition—one reason the current tight situation in the markets is likely to be with us for some time, and why frustration and anger with Big Oil will be a constant theme in politics around the world. ■

–By Stanley Reed in London and Christopher Palmeri in Los Angeles, with Eamon Javers in Washington

DETROIT

GETTING MORE MILES TO THE GALLON—FAST

Off-the-shelf technologies could increase fuel efficiency by up to 30%

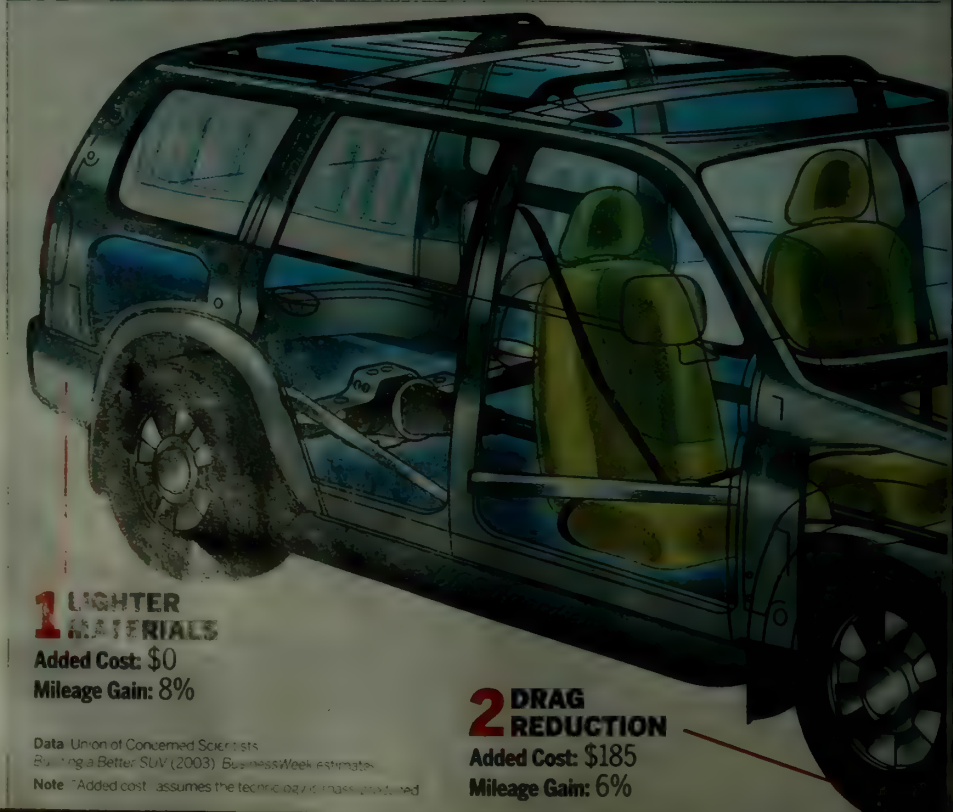
RECORD-HIGH PUMP prices have altered the rules of the game in the U.S. auto market. Following the post-Katrina price spike, the move away from gas guzzlers that began early this year—when gas was still south of $3 per gallon—could become a stampede. Executives and engineers in Tokyo, Stuttgart, and Detroit face a new commercial imperative: Roll out more efficient models, and fast.

It is possible. And it won't require hydrogen fuel cells, second-generation hybrids, or other cutting-edge options that will take years to scale up. Auto makers have a bag of well-rehearsed tricks that can be easily integrated into today's designs. Put them together, and they have the potential to achieve a mileage revolution. "Few auto makers have bothered to combine these things yet," says David Friedman, research director at the Union of Concerned Scientists, a nonpartisan Washington advocacy organization.

The key is integrating a variety of off-the-shelf technologies to make lighter

Fuel Miserly

Carmakers have plenty of tricks that could be integrated into current designs without breaking the bank



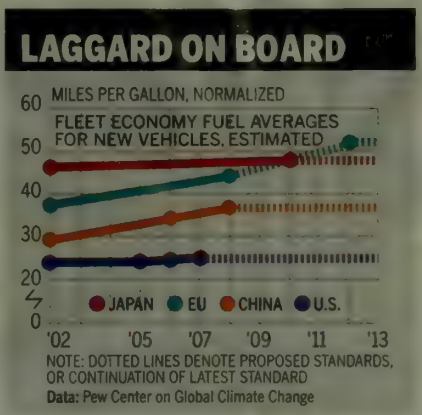
Data: Union of Concerned Scientists, Building a Better SUV (2003), BusinessWeek estimates
Note: *Added cost assumes the technology is mass-produced

nore aerodynamic vehicles powered by marter engines and transmissions—vithout sacrificing speed, safety, or vehile size. It may sound pie-in-the-sky, but nileage gains of up to 30% are possible at reasonable cost, according to studies by CS in 2003 and the National Academy f Sciences in 2002. Sport-utility vehicles nd trucks would benefit most, but cars nd minivans have room to improve, too.

Buyers are already beginning to vote vith their pocketbooks. In August—before Catrina and despite U.S. carmakers' sumnertime "employee discount" blitz—the ales share of large SUVs and trucks fell by wo percentage points, to 3.8%. "It's diffiult to find such a rapid fall in such a short eriod," says Jesse Toprak, a senior analyst t Edmunds.com. Meanwhile, the share of ompact cars sold rose to 17%, from 4.5%. "With a big consumer shift, auto nakers will have to focus on matching exsting technologies to optimize gas nileage," he adds.

Trends abroad are adding pressure. Regulators in China, Japan, and Europe ave continued to raise mileage standards. ndeed, in a 2004 study by the Pew Center n Global Climate Change that normalized nileage rules in top auto markets, U.S. ules ranked dead last, and the gap will nly widen as scheduled hikes overseas take effect. If carmakers don't meet those standards, it will crimp future sales. China, for example, is destined to be the world's largest car market, and Detroit wants a big piece of the action. Yet Beijing recently unveiled mileage goals that are 22% more demanding than today's U.S. levels, and should be 35% stricter still come 2008.

For carmakers eager to satisfy the wishes of economy-minded customers and regulators, there are plenty of options. The following technologies could boost mileage without sacrificing size or safety or breaking the bank.



1 LIGHTER MATERIALS For every 10% drop in weight, mileage improves by around 5%. One way is by combining body and frame elements into a simplified "unibody." That can boost mileage by 8%. For bigger gains, some companies are substituting costlier aluminum or high-strength steel. These materials are now being used more to boost performance than efficiency. Ford Motor Co.'s Jaguar division trimmed over 400 pounds from the XJ sedan partly by using aluminum in the frame. This yields better mileage from a somewhat smaller engine that can still keep pace with competing sedans. Combining these two approaches, while not cheap, could theoretically boost mileage in SUVs by up to 30% for less than $1,000, estimates UCS.

2 DRAG REDUCTION Friction is a mileage killer. First, there's rolling resistance from tires on the ground. Keeping tires properly inflated is one of the easiest ways to improve mileage today by up to 3%. Remote tire sensors—mandated after the Ford-Firestone debacle—will go part of the distance, as will improved tire designs that can run at higher pressures without sacrificing comfort.

Even minor reductions to aerodynamic resistance can bring benefits. Honda Motor Co.'s Pilot SUV is nearly as slippery as a car, largely because Honda rearranged components to smooth out its underbelly. The change was cheap, since it involved no new material. Getting rid of side-view mirrors is a possibility, too, thanks to the imminent introduction of tiny low-cost video cameras and displays on the inside of the car. For $180, figures UCS, SUV drag could be cut enough to boost mileage by up to 6%.

3 SMARTER ENGINES The motor remains the heart of the car—and still the source of potentially big efficiency gains, even after a century of evolution. Today's engines are digitally controlled wonders, served by sensors and electronics dedicated to boosting performance. Japanese carmakers have led the high-tech push, with advanced valve-timing-control technologies that minutely vary the flow of oxygen and gas into the cylinder. In the latest tweak of its flagship engine, Honda's i-VTEC eked out 6% more efficiency.

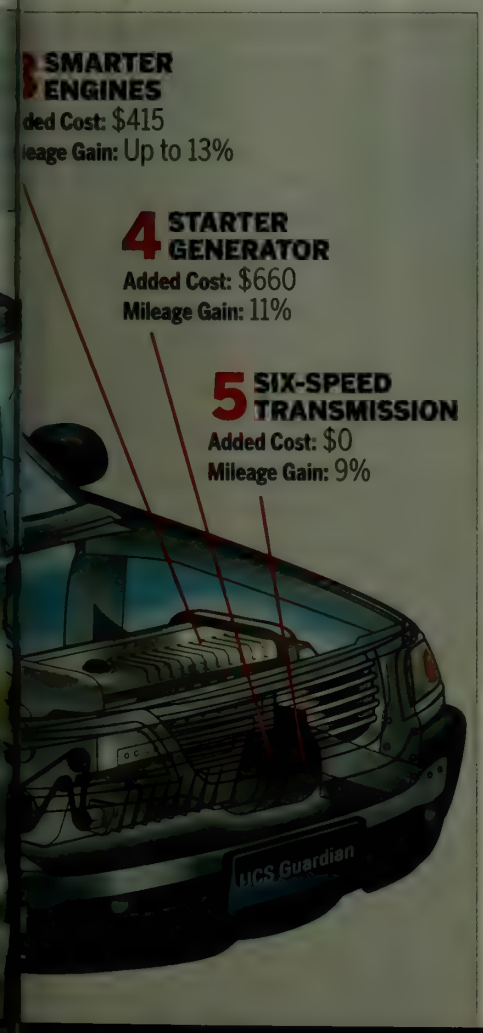
U.S. auto makers are squeezing out savings from older "pushrod" engine designs. Both GM and Chrysler Group sell models that shut down unneeded cylinders at highway speeds, when less power is needed to keep cruising. For GM, the approach boosts fuel efficiency by about 5% at an estimated cost of $50 per vehicle.

4 STARTER GENERATOR About 15% of gas is wasted when a car's engine idles during stops. By relying on superfast sensors and controllers, gas engines can be completely shut off at idle and switched on again faster than a driver can move from the brake to the gas pedal. The key is a "starter-generator" electric motor that spins the engine back to speed. GM put this technology on its GMC Sierra and Chevy Silverado hybrid pickups, contributing to mileage gains of about 10%.

5 SIX-SPEEDS Each additional gear widens the range of speeds at which an engine achieves maximum efficiency. So while 4-speed transmissions are good, 5-speeds are better. Even 6-speed gearboxes are no longer exotic. More than six is unlikely in the mass market, says Edmunds.com's Toprak, but going from 4- to 6-speeds can yield mileage gains of up to 7%. As production volumes grow and costs fall, 6-speed transmissions will become the norm.

None of these options is a cure-all. Then again, the search for a single magic solution to fuel savings will only delay adoption of incremental innovations. If combinations of these techniques can deliver a 30% mileage improvement, SUVs that get 15 mpg now could soon get 19.5 mpg. With gas at $3 per gallon, that difference would cut fuel costs for a 15,000-mile year by $700. Consumers are calculating the value of such savings—and showing a willingness to pay for them up front. ■

–By Adam Aston in New York



AFTER KATRINA

THE MOTHER OF ALL TOXIC CLEANUPS

No one knows how to deal with the untold tons of lethal goop—or who will pay

AS RESCUE WORKERS continue the grim search for bodies in New Orleans, environmental engineers are struggling with what will probably become the biggest challenge of Katrina—the mess. A toxic brew of oil, chemicals, bacteria, debris, and garbage must be cleared and the ground scrubbed before the city can be rebuilt. Unfortunately, the experts have few new ideas about how to tackle a cleanup of this scale. "There is no silver bullet, and I would be highly suspicious of anyone who says there is," says Calvin H. Ward, an environmental engineering professor at Rice University.

Federal and state scientists have started surveying the many cleanup issues. Those assessments are expected to take months, but the Environmental Protection Agency has already found that the floodwater pumped back into Lake Pontchartrain has extremely high levels of lead and sewage-related bacteria. The Coast Guard has reported at least five major oil leaks from damaged tanks and refineries, including 819,000 gallons spilled south of New Orleans. Then there's the 95-acre Superfund site near downtown New Orleans, a toxic former dump. Four years ago, it was covered with two feet of topsoil and protective sheeting. Now it's underwater and could be leaching chemicals.

Any one of these situations might be manageable, but taken together, the task leaves experts questioning where the resources will come from. The cost could run to tens of billions of dollars, especially if oil and chemicals seep deep into the ground. "We have cleaned up lots of other catastrophes and, quite candidly, this outstretches all of them combined," says William J. Geary, executive vice-president of Clean Harbors Inc., a leader in environmental cleanup, with workers already in the city. "This is orders of magnitude bigger than what any cleanup company would be familiar with."

OIL SPILL It could be in houses, sewers, and groundwater

The most immediate concern for health officials is the high levels of bacteria and lead in the rancid water covering much of New Orleans. The EPA has warned the water is so contaminated that people should not let it touch their skin and five Louisiana evacuees have died of a cholera-like illness. Yet that water, essentially raw sewage, is being pumped into Lake Pontchartrain.

There's no chance of treating the water as it goes into the lake, as nearly all the waste treatment plants in the region were damaged by the flood. Bacteria normally dies off from exposure to sun and seawater after a week or so, but the lake may be so starved of oxygen that the natural cycle will be inhibited. Ward says it would help if oxygen were pumped back into the lake—"nature does work if you let it"—but right now New Orleans' main priority is getting the water out of the city.

Oil and toxic chemical spills present a far more intractable problem. Contaminated topsoil can be scooped up by vacuum-like machines, but those devices can't get at muck that has seeped into houses, sewer lines, or groundwater. There are novel technologies that can be applied. Last year, for example, Solucorp Industries Ltd. in West Nyack, N.Y., introduced a chemical compound that prevents heavy metals such as mercury and lead from leaching into the soil and makes them safe for disposal. Solucorp President Noel F. Spindler says the technology has not been tried on any project as large as the Katrina disaster site, but it could be deployed in certain areas. Such reagents will likely not be useful, however, in locations where a complex chemical cocktail exists.

The biggest problem will be disposing of all the waste. "This is going to be an absolutely enormous volume, and I doubt that much of it will be able to be recycled," says Edward J. Bouwer, an environmental engineering professor at Johns Hopkins University. There is no landfill in the U.S. large enough to accommodate a trashed city, and scientists say there is a limit to how much other nations would be willing to take. "The logistics, the cost, the volume," laments Ward. "It's just a massive, massive problem." ■

–By Catherine Arnst in New York with Janet Ginsburg in Chicago

> "This is orders of magnitude bigger than what [anyone is] familiar with."
>
> *William J. Geary, executive vice-president of Clean Harbors Inc.*

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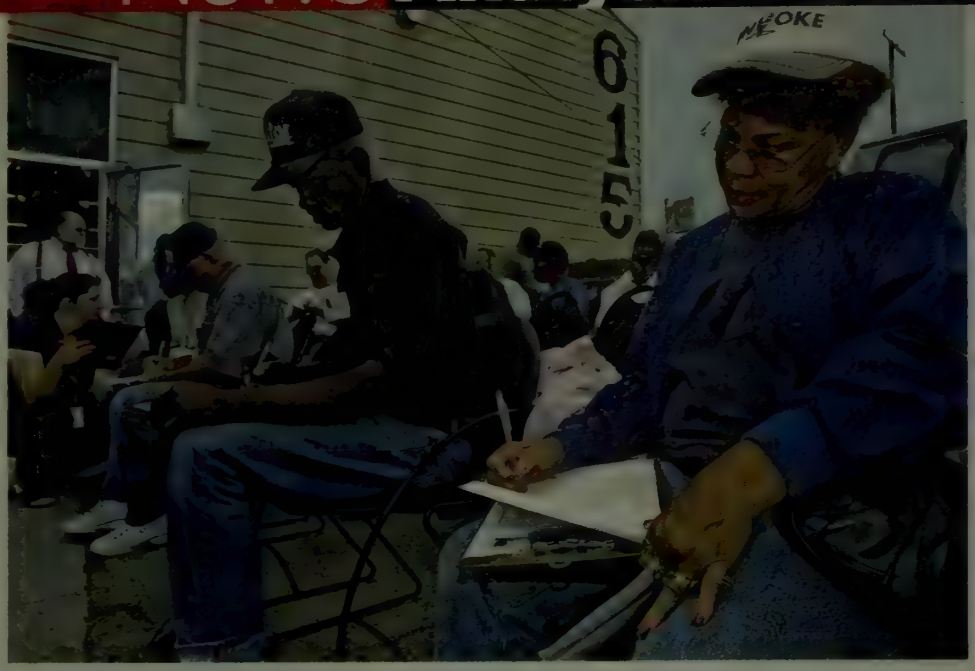


NAME, ADDRESS... A job fair in Utah, which can use the help

AFTER KATRINA

SWEPT AWAY, ONLY TO LAND ON THEIR FEET

Evacuees are finding a welcoming job market in Texas, Utah, and elsewhere

SANDRA GIBSON FIGURES she could have done better. The manager of the Austin (Tex.) office of Granite Construction Inc. hired eight evacuees from Hurricane Katrina as construction workers at a Sept. 12 jobs fair organized by Goodwill Industries. But she still has about 45 jobs she wants to fill. "I was hoping for more applicants," says Gibson, who notes that fewer people than expected showed up at the fair. "We're in the middle of a construction boom. The demand [for workers] is very high."

Cross one worry—getting a job—off the checklist for many of the Katrina victims scattered across the country. Nationwide, the job market is solid: August's 4.9% unemployment rate is the lowest in four years and close to what economists reckon is full employment. And 62.9% of the working-age population had jobs in August—the highest ratio of employment to population in nearly three years.

Perhaps more important, many hurricane victims have landed in stronger job markets than the ones they left in Louisiana and Mississippi before the storm. In July, the latest month for which state data is available, unemployment stood at 5.6% in Louisiana and 6.5% in Mississippi. Contrast that with two nearby states where lots of evacuees have come—5% unemployment in Texas and 4.9% in Arkansas. With unemployment numbers that low, there's demand for jobs requiring a wide variety of skills. "We've got everything from clerical positions with banks to customer service call center positions to light industrial, financial, and administrative jobs," says Joyce Russell, chief operating officer of temporary staffing outfit Adecco USA, which has already hired about 500 evacuees.

The story is similar across the country. In Salt Lake City, of the 85 evacuees who showed up at a Sept. jobs fair, 44 were hired on the spot and another 19 got appointments for a second interview. The offers were in construction, food services, telemarketing and customer service. "There's a shortage of people in Utah. This is a great place for [evacuees] to be," says Kimberly Barkdale, branch manager of temporary staffing agency Manpower Inc.'s Salt Lake City office, who found jobs for seven at the fair. Utah unemployment is 4.7%.

High Ground—and Jobs

Katrina victims are leaving behind Mississippi and Louisiana for states where unemployment is lower:

	UNEMPLOYMENT RATE
Mississippi	6.5%
Louisiana	5.6
Florida	3.8
Arkansas	4.9
Texas	5.0

Data: Bureau of Labor Statistics

NEW COMFORT ZONE

TEXAS, WHERE SOME quarter of a million Katrina victims have ended up, is also hiring. The WorkSource, which helps people find jobs in the Houston-Galveston area, has been flooded with offers. "In the first days after the evacuees started arriving we saw employers show up at the lower end and also the trades," says Carol Mitchener, a WorkSource director in Houston. "Now we're seeing many employers wanting people in the professions—nurses, teachers, accountants." Companies from Las Vegas, Atlanta, and California are flocking to Texas to recruit.

Greeted with strong demand for their services, many evacuees could opt to stay put in their new homes rather than return to the Gulf. Adrian Andrews, 37, says he plans to put down roots in Utah after landing a job at the local outlet of Cabela's Inc., a Sidney (Neb.)-based maker and retailer of hunting and fishing wear. His first day on the job was Sept. 12. Says Andrews: "We've really gotten comfortable here."

To be sure, those who fled the storm with few or no job skills will find it difficult landing a position no matter where they've ended up. But for many others, the transition is proving less difficult than first feared. "I'm surprised at how easily I got this job," says 27-year-old New Orleans native Keokee Bias, who's working as a customer service representative in St. Louis for billing-services firm Convergys Corp. "If I'd been at home in New Orleans, I wouldn't have found a job this quickly." ■

—By Rich Miller in Washington, with Mark Morrison in Austin, Tex., Olga Kharif in Portland, Ore., and Anne Therese Palmer in Chicago

COMMENTARY

BY JAMES E. ELLIS

The Law of Gravity Doesn't Apply

Inefficiency, overcapacity, huge debt...what keeps U.S. carriers up in the air?

WITH THE U.S. airline industry expected to lose at least $8 billion this year, United Airlines and US Airways Group already in bankruptcy, and Delta Air Lines and Northwest Airlines joining them on Sept. 14, you'd think the long-awaited day of reckoning was finally on the horizon.

Don't bet on it. The laws of economics seem to get skewed at higher altitudes. Rather than rising or falling solely on their ability to manage costs or fares, airlines today benefit from a complex web of relationships that seems destined to allow the industry to muddle through for years to come.

That's not to say the airlines haven't identified a key problem: too much capacity, which saps pricing power and boosts debt. Indeed, big carriers like United, American Airlines, and US Airways have collectively shuttered the equivalent of a major airline over the past few years. But they still face a Sisyphean challenge because of the industry's relatively low barriers to entry. Newcomers like JetBlue Airways Corp. and AirTran Airways Inc. add flights almost as quickly as the majors make cuts. And since those airlines usually have lower operating, salary, and pension costs than the shrinking legacy carriers, they're continually bringing price competition to a wider share of the market—starting the whole vicious cycle over again.

In many other businesses, such a dismal scenario would scare off investors, letting market forces shrink the industry until it reaches a size that yields consistent profits. But not airlines. There are just too many players eager to pitch in cash, despite a flawed business model. For example, General Electric Co.'s finance unit has bankrolled reorganizations at Delta, America West, and US Airways. It's no mere coincidence that another GE unit sells highly profitable engines to those same carriers.

Likewise, in return for wage concessions, employees have become major investors in carriers like Northwest, United, and US Airways. That saves the airlines hundreds of millions. Ditto for the pay-to-play deals big carriers force on their smaller commuter partners. But because workers and partners are often more concerned with keeping their jobs or lucrative feeder contracts than with allocating capital wisely, carriers with poor operating results or dim prospects are allowed to limp along. The feds contribute as well, although unwillingly: Experts say Delta could soon dump $8.4 billion of its pension liabilities on Washington.

Even state and local governments promote the status quo. Chicago, for example, gave now-bankrupt ATA Airlines $25 million in subsidies in 2001 to build an employee training center at Midway Airport. United Airlines bagged $300 million from Indianapolis and the state of Indiana in the 1990s to open a now-shuttered maintenance center there. And smaller cities like Wichita and Tupelo, Miss., routinely offer cash, tax breaks, or terminal subsidies to entice carriers to fly to their locales. Since few companies—airlines or otherwise—are in the business of turning down free money, capacity from subsidized routes gets added into the system, employees get hired to serve them, benefit and pension liabilities increase, and...you get the picture.

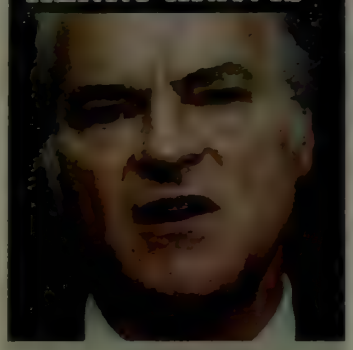
The real winners of this shell game, of course, are consumers, who have seen inflation-adjusted air fares fall 50% since 1978. Indeed, why would fliers (at least those who aren't airline employees or economists) really want a rational market where carriers are able to control capacity and set fares high enough to guarantee healthy profits? The airlines' current lack of pricing power is awful for the carriers and their investors: Shares of major airlines have logged a negative return of 54% since the beginning of 2000, and unsecured bondholders at Northwest may lose 90% of their investment. But the public is flying high—at least for now.

How can this dysfunctional, profitless business hang in year after year? Because many key constituents have little reason to want it to behave like a disciplined business. That's no way to run a railroad. Then, again, we're talking about airlines. ■

EDITED BY MONICA GAGNIER

HEADLINER

HENRY KRAVIS



HENRY THE IMMOVABLE

Long live King Henry! On Sept. 13, two key partners of Kohlberg Kravis Roberts, the buyout firm founded by Henry Kravis and his cousin George Roberts in 1976, announced that they will retire at yearend to start their own fund. The departures of B-school roommates Ned Gilhuly, 45, and Scott Stuart, 46, sparked some speculation over who will succeed Kravis and Roberts, both 61.

But their exits are actually one of the clearest signs yet that buyout king Kravis isn't leaving anytime soon. And why should he? Kravis is putting the final touches on a fund of about $5 billion for investing in Europe. He's opening offices in Hong Kong and Tokyo.

Besides, with private equity transactions all the rage, buyout firms soon may be able to get the financing to do deals not just worth billions—but tens of billions of dollars. Perhaps that's why Kravis continues to show up early at work every day. "[Kravis] is going 100 miles per hour," says Stuart. Doesn't sound like a man heading toward retirement.

–Emily Thornton

WACHOVIA WINS ONE

The bridesmaid is finally a bride. After losing out in the bidding for such plum targets as **FleetBoston Financial** and **MBNA**, **Wachovia** finally caught the bouquet with its Sept. 12 deal to acquire **Westcorp** for $3.9 billion. In winning Westcorp and its WFS Financial auto-lending subsidiary, the Charlotte (N.C.)-based bank solves a big problem it shares with its rivals: what to do with all the deposits it has attracted from consumers looking for a safe place to park their cash. Having been unable to persuade depositors to become customers for its loan products, Wachovia is using the Westcorp deal to vault it into the ranks of the largest auto lenders.

BRINGING IN THE SHAVES

Gillette one-upped rival **Schick** and its four-bladed Quattro razor on Sept. 14 when it unveiled the world's first five-bladed razor, known as Gillette Fusion. Men will have to pay dearly to trade up to Fusion when it goes on sale in both manual and battery-powered versions early next year. A four-pack of Fusion cartridges will cost at least $12, a 30% premium over Gillette's current top-of-the-line blades. Still, there's every reason to believe Fusion will become a huge hit. Consumer testing on 9,000 men found they preferred Fusion by a 2-to-1 margin over Mach3Turbo. And Gillette promises Fusion's launch will be backed by the biggest marketing program in its history, though it didn't reveal what it will spend on the campaign.

FAST CASH FOR FORD

Ford Motor took another step in its ongoing restructuring, selling **Hertz** to a private equity group. **Clayton, Dubilier & Rice, Carlyle Group**, and **Merrill Lynch Global Private Equity** bought the nation's No. 1 car rental company in a deal valued at $15 billion, including debt. Ford walks away with $5.6 billion in cash—about what Wall Street expected—to beef up its balance sheet. Thus ends Ford's on-again, off-again Hertz saga. Ford bought its first stake in 1987 and by 1994 owned the whole company. In 1997, Ford sold a minority interest in a public offering, but in 2001 it bought the stock back. In June, Ford said it would spin off part of Hertz in an initial public offering and sell the rest later. By selling Hertz outright, Ford collects the cash sooner.

A BROADBAND ARMS RACE

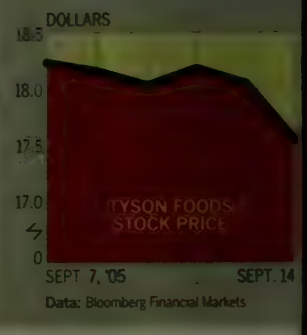
Cable operators are joining the rush to build Wi-Fi networks in towns across the U.S. to offer customers Internet access anywhere, even outside their homes. On Sept. 14, Wi-Fi equipment maker **Tropos Networks** teamed up with major cable equipment vendor **Scientific-Atlanta** to sell cable operato the systems they need to of such broadband services. Companies such as **Time Warner Cable** are consideri jumping into the business. Such a move could put Bel companies on the defensiv The local phone companie offer high-speed Internet access services that compe with cable-modem offering

ET CETERA...

- **Lehman Brothers** reporte 74% jump in net income fo the third quarter.
- Creditors of **US Airways** approved its bankruptcy reorganization plan.
- Apparel and hospitality union **UNITE Here** is leaving the **AFL-CIO.**

CLOSING BELL

Tyson Foods fell 2.2%, to 17.65, on Sept. 14—leaving it nearly 8% below its July 20 peak—amid investor concerns that earnings at the meat and poultry producer will suffer from Hurricane Katrina. On Sept. 6 Tyson warned that storm damage will reduce profits by up to $20 million.



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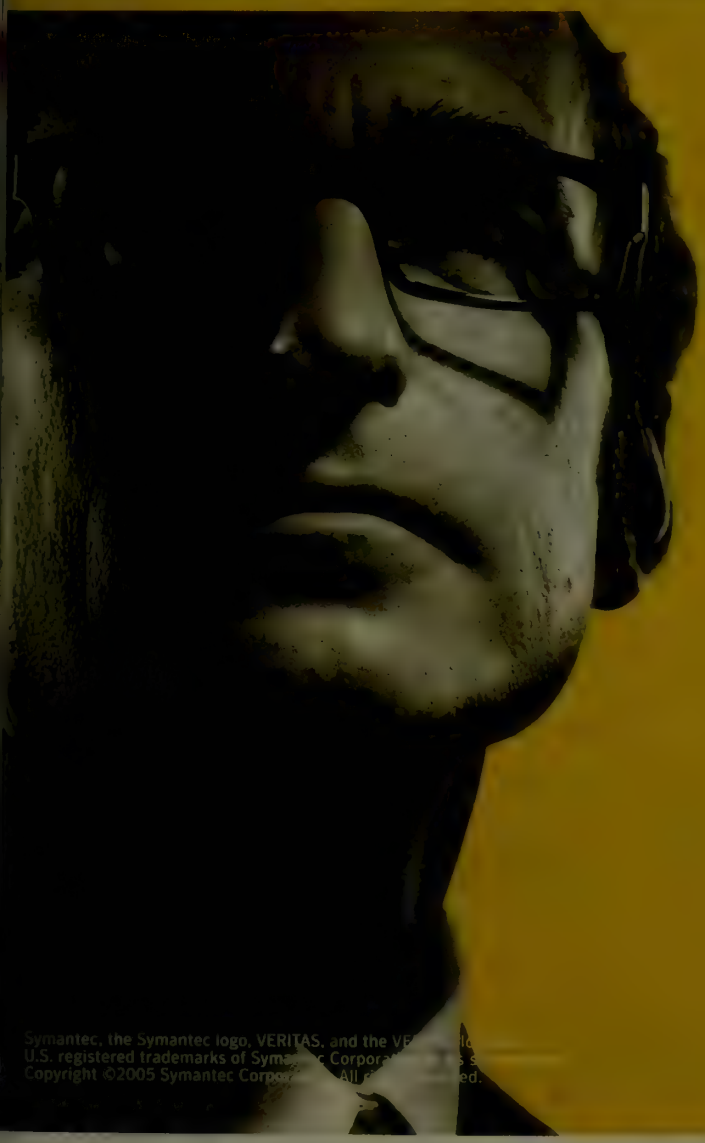

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Fears and Facts #1 in a series of strategic briefs

"WORST CASE SCENARIOS ARE RARELY THE BEST INVESTING GUIDE."

by Robert V. DiClemente,
Managing Director,
U.S. Head of Economic and
Market Analysis, Citigroup

Right now, investors are being bombarded by some rather extreme views. Things like a growing trade deficit, the possibility of a bursting housing bubble and the falling dollar are serious concerns, but how should they affect investors' decisions?

It's time to put aside emotion and understand the facts behind the risks.

That's why our research department wrote *Fears and Facts,* to give an informed assessment of important economic issues facing investors today.

Call 1-800-327-6748, ext. 534
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DITED BY RICHARD S. DUNHAM

Can Congress Dish Out Relief Without Pork?

N AUG. 28, WHILE HURRICANE KATRINA was devastating the Gulf Coast, Max Baucus of Montana, the senior Democrat on the Senate Finance Committee, was driving across Nevada. The panel's Republican chairman, Chuck Grassley, was back home in Iowa. Baucus reached out to Grassley by cell phone, and the two collegial lawmakers hashed out a package of tax breaks for hurricane victims.

Such collegiality is rare in an era of nasty partisanship. What's just as impressive is that in the immediate aftermath of the storm, Congress passed $62.3 billion in emergency spending and is moving ahead with immediate tax relief for Katrina's victims without larding the legislation with unrelated goodies. But Washington's pork-barrel proclivities will be hard to restrain when lawmakers consider the second stage of aid contemplated by Grassley and Baucus—more tax breaks to bolster rebuilding along the Gulf Coast, as well as an additional $50 billion in new emergency spending. "Instead of ambulance-chasing lawyers, we have pork-chasing lawmakers," says Thomas A. Schatz, president of Citizens Against Government Waste, a conservative watchdog group. "They want to tie any project to the latest disaster."

GRASSLEY and Baucus have kept goodies out of aid so far

Temptation beckons

THAT HASN'T happened—yet. Democrats and Republicans want to send a message to Katrina's victims: We care. So Congress is hustling to wrap up a quick spending bill—without the pork that has weighed down other emergency measures, such as Iraq war funding.

Grassley and Baucus envisioned a two-stage plan: immediate help and long-term reconstruction. First, they'd provide about $5 billion in short-term aid for those left homeless and jobless by Katrina. Hurricane victims could tap into their retirement plans and employers in the disaster zone would get incentives to keep workers on the payroll.

But fiscal conservatives are increasingly worried about Phase II. That's when lawmakers and lobbyists will be tempted to insert their own tax breaks. A second bill could give companies in the storm-ravaged region generous depreciation write-offs for the purchase of new buildings and equipment, create tax-advantaged enterprise zones in the Gulf states, and expand tax-exempt treatment for bonds to finance private construction projects. But pols are already pushing to expand those tax breaks—in the name of boosting the national economy. Several key Republicans, including House Majority Whip Roy Blunt (R-Mo.), are racing to promote post-Katrina stimulus. Such a bill could be loaded with unrelated tax goodies such as broad new investment incentives and breaks for building oil refineries that go beyond those in recently enacted energy legislation. Even Baucus won't rule out such changes. Among those looking for cash from a second spending bill are Midwestern farmers and Democratic Senator Dianne Feinstein, who wants help to shore up levees in California.

That may be a reason why James R. Horney, a senior budget analyst at the liberal Center on Budget & Policy Priorities, frets that a second bill "really scares me. There is a real fear that we'll end up with changes that have nothing to do with Katrina."

For now, most lawmakers still recognize that restraint is called for as the nation confronts a disaster of historic proportions. But this is Washington, where disaster is often a chance to hand out free money. ■

–By Howard Gleckman and Eamon Javers

CAPITAL WRAPUP

GUNS AND WATER: THE RAGE OF THE NRA

HURRICANE KATRINA has the gun lobby up in arms. The National Rifle Assn. says it has logged thousands of calls from firearms owners furious at reports that law enforcement officials seized guns from citizens trying to protect themselves from looters. The NRA also is looking into reports that the Bureau of Alcohol, Tobacco, Firearms & Explosives has been using gun shop records to track down New Orleans gun owners.

Were gun owners' rights violated in the storm?

The NRA is seeking a repeal of state laws, including those in Louisiana, that give the government broad leeway in regulating guns during a state of emergency. It also is demanding a congressional investigation into possible violations of civil liberties after the storm and a review of federal disaster laws. "When you have a total breakdown of law and order...that's exactly what the Second Amendment was designed for," says NRA CEO Wayne LaPierre Jr. "We're at the point where all people have to save their life and property is their firearm. They can't call 911."

Given the NRA's clout on the Hill, hearings will likely happen. It's harder to handicap the showdown at state capitals between law enforcement and the gun lobby. Meantime, gun sales are soaring, and the NRA is offering legal aid to gun owners who believe their constitutional rights have been violated.

–By Lorraine Woellert

CHINA

STEALING MANAGERS FROM THE BIG BOYS

Chinese companies are energetically wooing execs away from multinationals

BY JUST ABOUT ANY measure, Aaron Tong was a success. He was pulling down $100,000-plus as a senior manager of Motorola Inc.'s cellular division for Asia and had worked in Singapore and the U.S. But two years ago, when TV-and-phone-maker TCL Corp. asked if Tong might accept a position as vice-president, he jumped. The modest salary hike and stock options were welcome, but that wasn't what attracted him, says Tong, 42. "At a Chinese company, you can do a lot more important things than with a multinational."

Tong isn't the only Chinese manager being poached from the global giants. Tang Jun, president of NASDAQ-listed online gaming company Shanda Interactive Entertainment, served as president of Microsoft Corp.'s Chinese operations. Jean Cai, head of corporate communications at Lenovo, is an Ogilvy & Mather veteran. Telecom equipment maker Huawei has hired people away from Motorola and Nokia, while Haier (appliances), China Netcom (telecoms), and Brilliance China Automotive Holdings have lured staffers from consultants McKinsey, A.T. Kearney, and Boston Consulting Group. "We spend a lot of time advising multinationals on how to hold on to their best people," says Bill Henderson, managing partner for China at headhunters Egon Zehnder International.

This migration is a big change from five years ago, when no self-respecting white-collar worker in China would have dreamed of quitting a foreign company to join a local outfit. These days the turbocharged growth, global aspirations, and deep pockets of China's ambitious private companies are looking better all the time. In 2000 locals made up just 20% to 30% of managers recruited in China by headhunter Heidrick & Struggles. Today that figure is 60% to 70%. Local companies are "cherry-picking the best talent," says Steve Mullinjer, managing partner for China at Heidrick.

Managers say working for local co panies lets them take on more respon bility and make a greater contributi That's what made Wu Xianyong, a year-old native of the southern provi of Yunnan, quit flogging Crest toothpa and Pringles potato chips for Procte Gamble Co. In 2004, after nearly ni years at P&G, he moved to Li-Ning, C na's top athletic-shoe maker as vice pr ident for marketing. He has since tak on oversight of international business well. "Li-Ning can provide me with much better platform to play on," sa

JEAN CAI

Boot Camp

Many top managers at China's leading companies cut their teeth with multinationals

NAME	NEW JOB	FORMER COMPANY
Tang Jun	President, Shanda Entertainment	Microsoft
Weng Xiangwei	General manager, electronics retailer Gome	Morgan Stanley
Jean Cai	Corporate communications, PC maker Lenovo	Ogilvy & Mather
Wang Bo	Director, Network Solutions, Huawei	Nokia
Michael Zhang	CEO, Microport Medical	Guidant
Wu Xianyong	V-P marketing, intl. business; shoemaker Li-Ning	Procter & Gamble
Aaron Tong	V-P, TV and phonemaker TCL	Motorola
Deng Kangming	V-P for HR, Net auctioneer Alibaba	Microsoft

TANG JUN

MICHAEL ZH

IN DEMAND Weng left Morgan Stanley for electronics retailer Gome

Some execs take a pay cut in return for positions of greater power

u, who also snagged a 50% raise plus nerous stock options. "I'm not just anaging a brand. I do sports marketing, ents, and PR, and I manage research." fact, Li-Ning is chock-full of multinaonal alums: The vice-president for sales rmerly worked at Avon Products Inc., d the vice-president for footwear came om Nike Inc.

T THE GROUND RUNNING

UCH OF THE SHIFT stems from global pirations. By hiring execs with experice at multinationals, the Chinese figure, ey'll have a leg up when they go road. For instance Gome, China's No. 2 tailer, has ambitous plans to expand. So January it recruited Weng Xiangwei, a -year-old former vice-president in organ Stanley's mergers-and-acquisions team, as its strategy chief and finanal guru. "When a company grows to a rtain size, it needs to think about more an just where to open its next store," ys Weng, a Shanghai native with a PhD biophysics.

Some managers take a pay cut when ey jump ship—although stock options ten fill in the gap. That trend is likely to celerate as more private Chinese comanies list on overseas stock markets. eng Kangming, for example, saw his lary drop by 20% when he left his job as head of human resources at Microsoft in Beijing for a similar job at Net auctioneer Alibaba Technology, but he was granted a generous dollop of options. And two years ago, 27-year-old Zhou Donglei took a 35% cut when she left Japan's Softbank Infrastructure Fund in Beijing to run business development and investor relations at Shanda. "What drew me was the opportunity, not the salary," says Zhou.

Yet salary can play a role in many searches. One veteran of the Bank of China saw his pay jump in just six months from $70,000 to $180,000 after a bidding war broke out for his talents among a foreign bank and two Chinese companies, says Heidrick & Struggles: The manager ended up as CFO for a valve maker.

China's state-owned giants are also likely to pay a premium to woo top talent. For instance, Ping An Insurance Group, China's No. 2 life insurer, has hired managers away from Canadian Imperial Bank of Commerce and American International Group—often upping their pay by as much as 50%. Ping An just hired a manager with five years of experience at an international bank for $65,000 per year—40% more than his old job paid.

Chinese companies are even starting to look overseas for talent. Michael Zhang, a 37-year-old native of Sichuan province, worked for four years at medical device maker Guidant Corp. before being recruited as CEO of Microport Medical (Shanghai) Co., which makes stents used in unblocking arteries. He, in turn, hired 33-year-old Zhao Ruilin, who had joined rival device-maker Medtronic Inc. in Minneapolis after earning a PhD from a Harvard University/Massachusetts Institute of Technology joint program in health sciences and technology, as well as an MBA from Wharton. Zhao now serves as Microport's vice-president for business development and strategic planning. He gets free housing and earns just $60,000—a bit more than half what he made at Medtronic. Still, he says, his greater responsibilities, coupled with Microport's hypergrowth—sales this year are expected to triple, to $30 million—make up for the pay cut. "Working for this company is so much fun," Zhao says. "Now I'm interacting with bankers, private equity shops, lawyers, and accountants."

The drive for talent by Chinese companies feeds into the general boom for middle and upper managers. One recruiter estimates CEOs at Chinese state-owned companies can earn $300,000 a year plus a car and housing, while middle managers with the right skills pull down $70,000 or more. Annual raises of about 13% to 14% are necessary to hold on to employees, while poachers are offering pay jumps of 20% to 30%, according to Hong Kong recruiting firm Bo Le Associates.

Don't expect things to cool off anytime soon. China will need 75,000 globally capable execs in the next five years but has fewer than 5,000 today, says McKinsey. As long as multinationals keep training locals, there will be no shortage of mainland rivals eager to snatch them away. ■

–By Frederik Balfour in Shanghai, with Dexter Roberts in Beijing

JAPAN

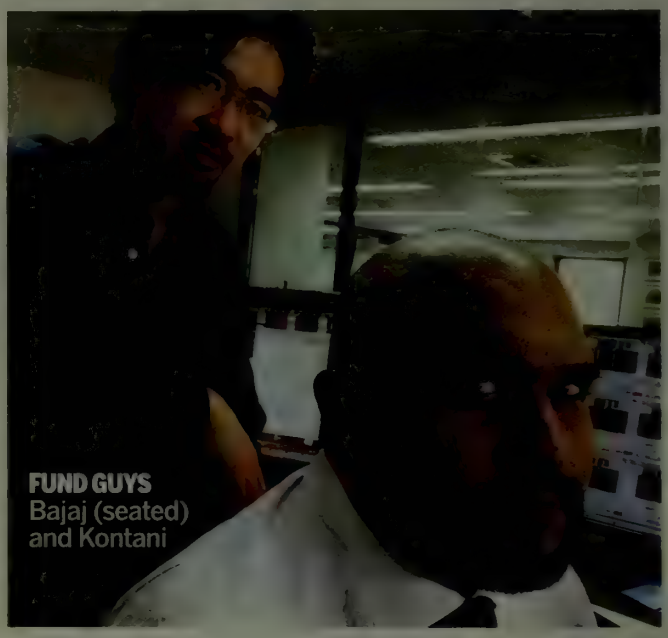
HEYDAY FOR HEDGE FUNDS

New ones are sprouting and thriving in Japan—despite the red tape

ON A STEAMY SUMMER evening in Tokyo, more than 200 young Japnese and Westerners dressed in dark pinstripe suits gather to swap business cards and clink free mugs of beer courtesy of a leading European brokerage house. The occasion? An invitation-only hedge fund networking event on the terrace of a French bistro, drawing some of the top talent in Japan. Five years ago only a handful of hedge fund managers operated out of Tokyo. But today the alternative investment community is mushrooming as billions of dollars, euros, and yen seek exposure to Japanese markets with a hedge fund twist. "The environment is finally ripening for hedge funds," says Masaru Kontani, managing director at Tokyo-based Hachibushu Capital Ltd.

Indeed, hedge funds, which invest for institutions and wealthy individuals by making bets on stock and bond market movements, are hot all over Asia. Assets under management in Asia-focused funds have been growing at a rate of 35% a year since 2000, according to researcher Eurekahedge, and some 607 Asian hedge funds now manage $70 billion. Japan, with its deep capital markets, accounts for about 30% of that.

And Japan-focused funds are on a hot streak. Eurekahedge's Japan Hedge Fund Index is up 7.83% for the year, compared with 3.93% for North American hedge funds and 1.19% for the Standard & Poor's 500-stock index. One Japanese-run fund, Tower Investment Management Co., did so well last year that a senior trader became Japan's No. 1 taxpayer, with estimated income of $100 million.



FUND GUYS
Bajaj (seated) and Kontani

THE STAT

$24 Million

Assets in Jap focused hed funds

Data: Eure

Traditionally, Japan's insurance companies and pension plans have parked their assets in low-risk corporate and government bonds. But yields have been at record lows, and there is concern that bond prices will crash if, as the economy improves, interest rates rise. Moreover, given Japan's aging population, pension funds must earn more on investments or raise contribution rates. "It's one of the great unanswered questions of the global economy: How can Japanese assets be more efficiently allocated?" says Mark Mason, a Japanese finance expert at Columbia University in New York.

To narrow the gap, Japanese institutions, like their counterparts in the West, have begun to diversify into hedge funds or hedge-like investments. A Nikko Asset Managem survey last November found more than of the responding Japanese corporate p sion funds had begun to invest in he funds just in the previous 12 mon "We're seeing more Japanese corpo pension fund money all the time," s Makoto Kikuchi, CEO of Myojo Asset M agement, which manages $570 milli The amount institutions invest is ra more than 3% of their assets. And they u ally invest in funds-of-funds to limit r "We use funds-of-funds as gatekeepe says Nobuki Yasuda, general manage alternative investments at Sumitomo Insurance Co., which invests about 2% its $200 billion in assets in hedge fun "It's hard to find jew among the rocks."

OFF LIMITS

THE POT OF GOLD at end of the rainbow hedge funds is Japa conservative public p sion system, which ov sees $1.3 trillion in ass For now, that money off limits. But that n change once the gove ment sets up a new m agement organization April. "The financial c dition of the public p sion system is deterio ing, so we need consider a more dive range of investment says Noboru Terada, ecutive investment officer of Japan's G ernment Pension Investment Fund.

Yet for Tokyo-based hedge funds truly thrive, Japan will have to do m than just tolerate their existence. Ri now, an opaque licensing process a heavy tax liabilities mean that m Japan-focused funds must execute tra through offices in Hong Kong, Singapo or even Honolulu. Japanese financial thorities seem unsure whether to e brace the fledgling industry or chase away. "From a regulatory point of vi Japan has been behind the curve," s Jason Bajaj, who runs Hachibushu Ca tal, which manages some $300 millio

Of course, the big concern of officials Japan is the same as that of offici everywhere—that hedge funds are sec tive, unregulated, often volatile vehic that have been known to abruptly c lapse, destabilizing the financial syste But until the next meltdown, Japan's n cent industry will continue to bloom.

–By Chester Dawson in To

new

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Even when your restless mind keeps you awake, brand new Lunesta can give your body and mind the soothing sleep you need. Lunesta not only helps most people fall asleep fast, it helps you sleep all through the night. Peacefully, uninterrupted. Lunesta works quickly, so you should only take it right before bed. And Lunesta is non-narcotic, and approved for long-term use. Of course, do not use sleep medicines for extended periods without first talking to your doctor.

Now's the time to catch the sleep you need. If you've been hesitant to take a prescription sleep aid, be sure to ask your doctor about Lunesta.

Important Safety Information: Be sure you have at least eight hours to devote to sleep before becoming active. Until you know how you'll react to Lunesta, you should not drive or operate machinery. Do not use alcohol while taking Lunesta. All sleep medicines carry some risk of dependency. Side effects may include unpleasant taste, headache, drowsiness and dizziness. *See important patient information on the next page.*

Leave the rest to Lunesta

2005 Sepracor Inc.

1-800-Lunesta www.lunesta.com

Lunesta™
(eszopiclone)
1, 2 AND 3 MG TABLETS

Please read this summary of information about LUNESTA before you talk to your doctor or start using LUNESTA. It is not meant to take the place of your doctor's instructions. If you have any questions about LUNESTA tablets, be sure to ask your doctor or pharmacist.

LUNESTA is used to treat different types of sleep problems, such as difficulty in falling asleep, difficulty in maintaining sleep during the night, and waking up too early in the morning. Most people with insomnia have more than one of these problems. You should take LUNESTA immediately before going to bed because of the risk of falling.

LUNESTA belongs to a group of medicines known as "hypnotics" or, simply, sleep medicines. There are many different sleep medicines available to help people sleep better. Insomnia is often transient and intermittent. It usually requires treatment for only a short time, usually 7 to 10 days up to 2 weeks. If your insomnia does not improve after 7 to 10 days of treatment, see your doctor, because it may be a sign of an underlying condition. Some people have chronic sleep problems that may require more prolonged use of sleep medicine. However, you should not use these medicines for long periods without talking with your doctor about the risks and benefits of prolonged use.

Side Effects

All medicines have side effects. The most common side effects of sleep medicines are:

- Drowsiness
- Dizziness
- Lightheadedness
- Difficulty with coordination

Sleep medicines can make you sleepy during the day. How drowsy you feel depends upon how your body reacts to the medicine, which sleep medicine you are taking, and how large a dose your doctor has prescribed. Daytime drowsiness is best avoided by taking the lowest dose possible that will still help you sleep at night. Your doctor will work with you to find the dose of LUNESTA that is best for you. Some people taking LUNESTA have reported next-day sleepiness.

To manage these side effects while you are taking this medicine:

- When you first start taking LUNESTA or any other sleep medicine, until you know whether the medicine will still have some effect on you the next day, use extreme care while doing anything that requires complete alertness, such as driving a car, operating machinery, or piloting an aircraft.
- Do not drink alcohol when you are taking LUNESTA or any sleep medicine. Alcohol can increase the side effects of LUNESTA or any other sleep medicine.
- Do not take any other medicines without asking your doctor first. This includes medicines you can buy without a prescription. Some medicines can cause drowsiness and are best avoided while taking LUNESTA.
- Always take the exact dose of LUNESTA prescribed by your doctor. Never change your dose without talking to your doctor first.

Special Concerns

There are some special problems that may occur while taking sleep medicines.

Memory Problems

Sleep medicines may cause a special type of memory loss or "amnesia." When this occurs, a person may not remember what has happened for several hours after taking the medicine. This is usually not a problem since most people fall asleep after taking the medicine. Memory loss can be a problem, however, when sleep medicines are taken while traveling, such as during an airplane flight and the person wakes up before the effect of the medicine is gone. This has been called "traveler's amnesia." Memory problems have been reported rarely by patients taking LUNESTA in clinical studies. In most cases, memory problems can be avoided if you take LUNESTA only when you are able to get a full night of sleep before you need to be active again. Be sure to talk to your doctor if you think you are having memory problems.

Tolerance

When sleep medicines are used every night for more than a few weeks, they may lose their effectiveness in helping you sleep. This is known as "tolerance." Development of tolerance to LUNESTA was not observed in a clinical study of 6 months' duration. Insomnia is often transient and intermittent, and prolonged use of sleep medicines is generally not necessary. Some people, though, have chronic sleep problems that may require more prolonged use of sleep medicine. If your sleep problems continue, consult your doctor, who will determine whether other measures are needed to overcome your sleep problems.

Dependence

Sleep medicines can cause dependence in some people, especially when these medicines are used regularly for longer than a few weeks or at high doses. Dependence is the need to continue taking a medicine because stopping it is unpleasant.

When people develop dependence, stopping the medicine suddenly may cause unpleasant symptoms (see *Withdrawal* below). They may find they have to keep taking the medicine either at the prescribed dose or at increasing doses just to avoid withdrawal symptoms.

All people taking sleep medicines have some risk of becoming dependent on the medicine. However, people who have been dependent on alcohol or other drugs in the past may have a higher chance of becoming addicted to sleep medicines. This possibility must be considered before using these medicines for more than a few weeks. If you have been addicted to alcohol or drugs in the past, it is important to tell your doctor before starting LUNESTA or any sleep medicine.

Withdrawal

Withdrawal symptoms may occur when sleep medicines are stopped suddenly after being used daily for a long time. In some cases, these symptoms can occur even if the medicine has been used for only a week or two. In mild cases, withdrawal symptoms may include unpleasant feelings. In more severe cases, abdominal and muscle cramps, vomiting, sweating, shakiness, and, rarely, seizures may occur. These more severe withdrawal symptoms are very uncommon. Although withdrawal symptoms have not been observed in the relatively limited controlled trials experience with LUNESTA, there is, nevertheless, the risk of such events in association with the use of any sleep medicine.

Another problem that may occur when sleep medicines are stopped is known as "rebound insomnia." This means that a person may have more trouble sleeping the first few nights after the medicine is stopped than before starting the medicine. If you should experience rebound insomnia, do not get discouraged. This problem usually goes away on its own after 1 or 2 nights.

If you have been taking LUNESTA or any other sleep medicine for more than 1 or 2 weeks, do not stop taking it on your own. Always follow your doctor's directions.

Changes In Behavior And Thinking

Some people using sleep medicines have experienced unusual changes in their thinking and/or behavior. These effects are not common. However, they have included:

- More outgoing or aggressive behavior than normal
- Confusion
- Strange behavior
- Agitation
- Hallucinations
- Worsening of depression
- Suicidal thoughts

How often these effects occur depends on several factors, such as a person's general health, the use of other medicines, and which sleep medicine is being used. Clinical experience with LUNESTA suggests that it is rarely associated with these behavior changes.

It is also important to realize it is rarely clear whether these behavior changes are caused by the medicine, are caused by an illness, or have occurred on their own. In fact, sleep problems that do not improve may be due to illnesses that were present before the medicine was used. If you or your family notice any changes in your behavior, or if you have any unusu disturbing thoughts, call your doctor immediately.

Pregnancy And Breastfeeding

Sleep medicines may cause sedation or other pote effects in the unborn baby when used during the last w of pregnancy. Be sure to tell your doctor if you are pregn if you are planning to become pregnant, or if you bec pregnant while taking LUNESTA.

In addition, a very small amount of LUNESTA may be pre in breast milk after use of the medication. The effects of small amounts of LUNESTA on an infant are not kn therefore, as with all other prescription sleep medicines, recommended that you not take LUNESTA if you are bre feeding a baby.

Safe Use Of Sleep Medicines

To ensure the safe and effective use of LUNESTA or any o sleep medicine, you should observe the following cauti

1. LUNESTA is a prescription medicine and shoul used ONLY as directed by your doctor. Follow y doctor's instructions about how to take, when to t and how long to take LUNESTA.
2. Never use LUNESTA or any other sleep medicine longer than directed by your doctor.
3. If you notice any unusual and/or disturbing thoug or behavior during treatment with LUNESTA or other sleep medicine, contact your doctor.
4. Tell your doctor about any medicines you may taking, including medicines you may buy withou prescription and herbal preparations. You should tell your doctor if you drink alcohol. DO NOT use alc while taking LUNESTA or any other sleep medicine
5. Do not take LUNESTA unless you are able to get 8 more hours of sleep before you must be active ag
6. Do not increase the prescribed dose of LUNESTA any other sleep medicine unless instructed by y doctor.
7. When you first start taking LUNESTA or any o sleep medicine, until you know whether the medic will still have some effect on you the next day, extreme care while doing anything that requ complete alertness, such as driving a car, operat machinery, or piloting an aircraft.
8. Be aware that you may have more sleeping proble the first night or two after stopping any sleep medic
9. Be sure to tell your doctor if you are pregnant you are planning to become pregnant, if you beco pregnant, or if you are breastfeeding a baby wh taking LUNESTA.
10. As with all prescription medicines, never sh LUNESTA or any other sleep medicine with any else. Always store LUNESTA or any other sleep medic in the original container and out of reach of childre
11. Be sure to tell your doctor if you suffer from depressi
12. LUNESTA works very quickly. You should only t LUNESTA immediately before going to bed.
13. For LUNESTA to work best, you should not take it w or immediately after a high-fat, heavy meal.
14. Some people, such as older adults (i.e., ages 65 a over) and people with liver disease, should start w the lower dose (1 mg) of LUNESTA. Your doctor m choose to start therapy at 2 mg. In general, adu under age 65 should be treated with 2 or 3 mg.
15. Each tablet is a single dose; do not crush or bre the tablet.

Note: This summary provides important information ab LUNESTA. If you would like more information, ask y doctor or pharmacist to let you read the Prescribi Information and then discuss it with him or her.

Rx only

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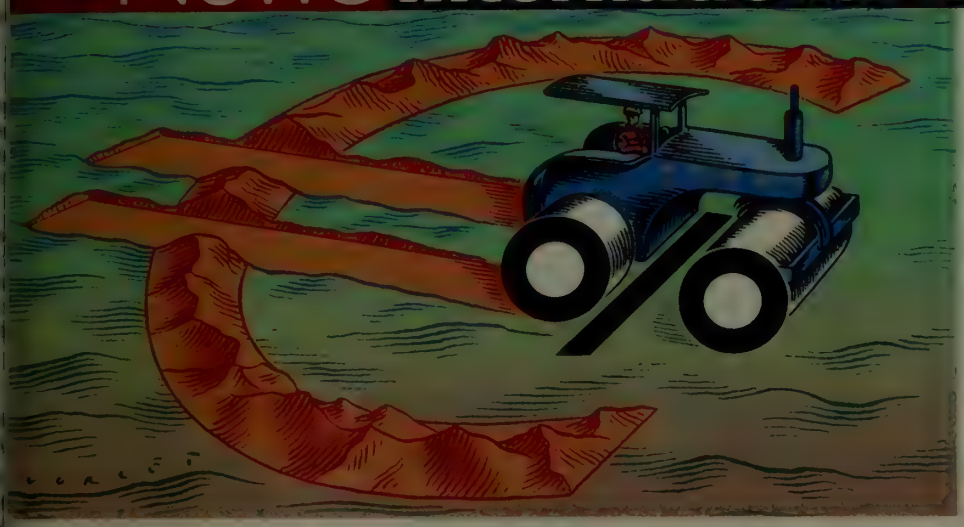


AXATION

EUROPE IS CIRCLING THE FLAT TAX

The success of a single tax rate in the East purs Western Europe to take a closer look

THE FLAT TAX. IN THE eyes of many fiscal conservatives, it's the Holy Grail of public policy: one low income tax rate paid by all but the poorest wage-earners, who are exempt. o loopholes for the rich to exploit. No raduated rates that take a higher percentage of income from eople who work hard to arn more. No need for a uge bureaucracy to police endishly complex tax laws. .S. conservatives have ng pushed the idea. But it as gotten its first road test n the old Soviet bloc, here countries from Estonia to Russia have enacted at taxes.

Most of these countries' conomies are growing at a ar healthier clip than those f their neighbors to the est. So it's no surprise that alls for a flat tax are now eing heard in Western Europe. Angela Merkel, the hristian Democratic nion's candidate for Chancellor in Germany's Sept. 18 elections, chose a leading flat-tax advocate as one of her main economic advisers. In Britain, the opposition Conservatives on Sept. 7 announced they would set up a commission to study a flat tax. Günther Fehlinger, president of Europeans for Tax Reform, a Vienna-based flat-tax advocacy group, sees interest picking up since last year. That's when a flat tax took effect in Slovakia, whose auto industry is luring investment away from Western Europe. "That changed everything," he says.

The issue is so politically explosive that no Western European government is likely to impose a flat-tax regime anytime soon. German Chancellor Gerhard Schröder's center-left Social Democratic Party has scored points in the campaign by branding Merkel's pro-flat-tax adviser, Paul Kirchhof, a radical who would cut taxes for the rich. Kirchhof, a professor of tax law at the University of Heidelberg, has in the past advocated placing a 25% tax on all income above $22,000 a year.

SIMPLIFICATION RISING

BUT TAX SIMPLIFICATION is clearly in the air. The platform of Germany's CDU, which Kirchhof now says he supports, calls for cutting the top personal income rate and axing tax shelters. France's center-right government plans to reduce the number of tax brackets from seven to five, trim the top marginal rate from 48.1% to 40%, and limit individual deductions, starting in 2007. By yearend, Spain's Finance Minister is expected to propose cutting the top personal income tax rate, now 45%, and reducing the number of tax brackets, now five.

Even without pressure from the East, many Western European governments face growing complaints. France offers 560 tax breaks that cost it more than $60 billion a year. In Britain, in early September, a parliamentary committee blasted the gnarly system of tax credits for the nation's poor households, calling it a "nightmare." That prompted George Osborne, the Tories' shadow Chancellor of the Exchequer and a flat-tax fan, to appoint a commission to study the introduction of a single rate.

There's no guarantee, of course, that flat taxes would work in Western Europe as they have in the East, where tax evasion ruled. But a flat or streamlined tax code could go a long way toward restoring public trust in the tax system by ending loopholes and cutting mounds of red tape. Flat-tax Europe? It won't happen overnight. But the conversation is getting under way. ■

–By Carol Matlack in Paris, with Jack Ewing in Frankfurt, and bureau reports

A Taxing Trend in the East...

Many Eastern European countries have adopted a flat rate for income tax in recent years:

COUNTRY	YEAR	RATE
Estonia	1994	23%
Latvia	1995	25
Russia	2001	13
Serbia	2003	14
Slovakia	2003	19
Ukraine	2003	13
Georgia	2004	12
Romania	2005	16

Data: Hoover Institution

...Picks up Steam in the West

Now several Western European nations are mulling proposals to simplify personal taxes:

GERMANY Angela Merkel's CDU party, ahead in polls for the Sept. 18 election, favors reducing the number of tax brackets and scaling back loopholes

FRANCE Chirac's center-right government plans to go from seven tax brackets to five and limit annual deductions to $9,400 per taxpayer, starting in 2007

BRITAIN Conservative opposition leaders are floating a proposal to replace three-bracket tax system with a low, flat rate

Data: BusinessWeek

AUTOS

GM STARTS GETTING TRACTION IN EUROPE

It actually turned a small profit last quarter, but it's not out of the ditch yet

THERE WAS a time when the execs at General Motors Corp. could expect nothing but trouble from their European operations. GM Europe piled up $3.9 billion in losses over the past five years, a result of lackluster styling, quality problems, and high labor costs.

But now the beleaguered Detroit auto maker is finally getting some traction on the other side of the Atlantic. GM Europe, which includes the German Adam Opel unit and Swedish Saab, posted a $36 million operating profit in the second quarter of this year, on sales of $8.5 billion. Analysts expect GM Europe to just about break even this year.

That's just one sign GM Europe Chairman Frederick A. "Fritz" Henderson's restructuring plan—GM's second in four years—is finally yielding dividends. Opel and its sister company, Vauxhall Motors Ltd., have successes to brag about. The latest generation $19,600 Astra compact, introduced in 2004, is closing in on the VW Golf in the race for the title of best-selling car in Europe, and the new $24,000 Zafira compact van is off to a strong start. These new models—along with strong sales of Korean-made Chevrolets—nudged up GM's share in Europe to 9.7% in the third quarter, from 8.6% three years ago.

FRANKFURT AUTO SHOW The new Astra Twin Top

GM Europe On the Mend

Signs of a turnaround at GM's European unit

PROFITS
After five years and $3.9 billion in losses, GM Europe posted a $36 million operating profit in the second quarter

MARKET SHARE
GM's share edged up to 9.7%, from 8.6% in 2002, despite competition from German luxury brands and Korean and Japanese carmakers

RIVALS
The Opel Astra now outsells the Ford Focus and is narrowing the gap with the Volkswagen Golf

Next year, GM will launch an Astra convertible, an athletic-looking crossover sport-utility vehicle called the Altara, and a Corsa subcompact to replace a boring model that lost out to sharper-looking competitors. "The products coming to market now and those in the pipeline show the true spirit of GM," Vice-Chairman Robert A. Lutz told the crowd at the Frankfurt Motor Show on Sept. 12.

After losing $2.5 billion in North America in the first half of the year, GM sure could use a pickup in Europe. But don't call this a full-fledged turnaro yet. GM is challenged by resurg French carmakers PSA Peugeot Citr and Renault, fast-growing Toyota, Korean upstart Hyundai. What's more, American giant is weak in the luxury m ket. "The second-quarter profit is n and it's a start," says Henderson, who s cessfully patched up Isuzu Motors I and stanched the bleeding in GM's La American business. But, GM's Mr. F adds, "we have a lot more work to do."

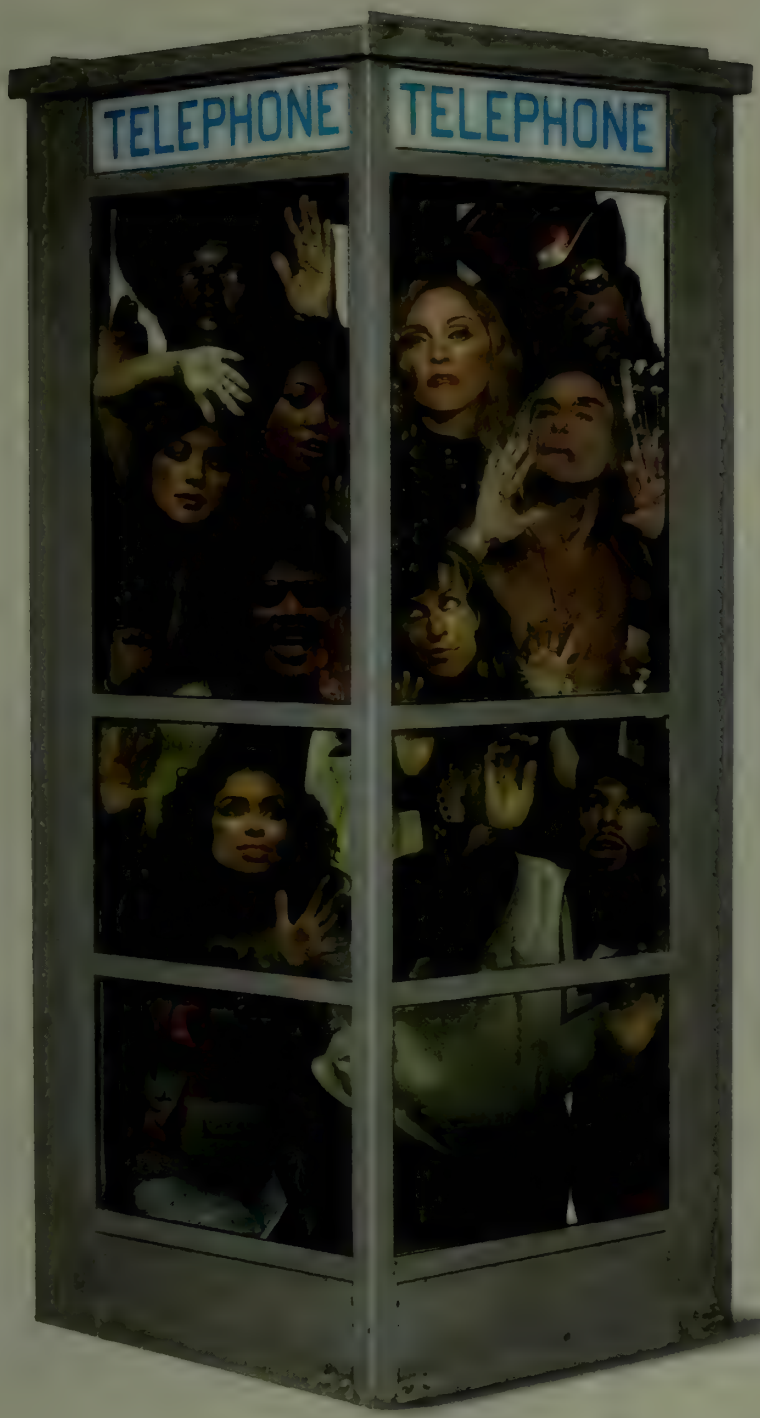
EDGY GOOD LOOKS

AT LEAST HENDERSON can count spruced-up models to rev sales. GM l been losing ground in Europe since mid-1990s because slipping quality and c styling. But quality is across the board, acco ing to J.D. Power & As ciates, and the styling the new Astra compac which has a sporty sta sculpted with a dash avant-garde edgines has won converts. T 240-horsepower As OPC performance also has added spark GM's image.

The launch of the n Astra Twin Top conv ible—a popular segm the company joined lat could drive sales of Astra to well o 500,000 next year, s GM President Carl-Pe Forster, the executive w initiated the face-lift the European line That's 25% higher th the previous generati sold in its last year. T car has the Astra's ed looks and a hard top th automatically retracts the push of a button.

One area to watch GM's efforts to promote Cadillac in E rope, where sales of the luxury marq number only a few thousand. Cadillac w have a serious European entry next spri with the launch of the BLS, a new mids sports sedan with brash American styli and the lithe frame and diesel engine E ropeans crave. Says GM'S Forster: "W have to build the brand step by step." GM can sustain its momentum in Euro it may generate enough profit to build t brand even faster. ■

–By David Welch in Frankfi



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EDITED BY ROSE BRADY

Warning Flags For Investors in India

NDIA'S STOCK MARKET has been on a tear. On Sept. 9 the Bombay Sensitive Index crossed the 8,000 mark to close at a record 8,052. The 12.5% surge came just 55 days after the market opped the 7,000 milestone. Foreign investors are pouring $1 billion a month into the market. And why not? Indian corporate profits have been growing at over 30% annually for three years, while the economy is hugging along at 7% growth rates.

But there's a potentially dangerous disconnect between the market in Bombay and the corridors of power in New Delhi. The soaring Sensex doesn't reflect a recent slowdown in reform, or political pressures on Prime Minister Manmohan Singh. In the last few months, Communists in the Congress Party-led ruling coalition have blocked nearly all efforts at economic liberalization. That's a setback for Singh, the architect of India's economic opening in 1991, who became Prime Minister in May, 2004. "The stock market is no longer a real barometer of the economy," argues Prithvi Haldea, chief executive of New Delhi researcher Prime Database.

The implications could prove important for India's longer-term growth. Faced with opposition from hardliner Prakash Karat, leader of the Communist Party of India, and other leftists, Singh has had to take privatization of state-owned companies off the agenda. Labor reform, which would have allowed easier hiring and firing of workers, has stalled, as have plans to lift limits on foreign direct investment in banking and insurance. Only aviation and construction have been opened to private investment, and some limited pension reform introduced. In their latest move, Communists are battling proposals to allow foreign participants in India's retail trade, which they fear will hit mom-and-pop stores. "The Left wants to demonstrate to its constituents that it calls the shots in Delhi," says Partha Nath Mukherji, a senior researcher at New Delhi's Institute of Social Studies.

PRESSURED Singh has had to slow down reform

A $30 billion hole

SINGH ALSO FACES resistance from socialists in his own party. Even Sonia Gandhi, the powerful Congress Party leader, is acting more populist than reformist. With an eye on future elections, she is pushing a rural employment scheme that would guarantee one member of each rural household 100 days of labor. That could blow a $30 billion hole in India's finances and boost the fiscal deficit, already 10% of gross domestic product. It would also soak up funds needed for infrastructure improvements.

Business is concerned about the slow reform pace. Nandan M. Nilekani, CEO of software player Infosys Technologies Ltd., maintains that India will keep growing at 7% for now. But he's worried about the longer term, because more than 14 million Indians enter the job market each year. The growth rate "is not enough to meet the demographic challenge. For that we need 9% to 10% growth," Nilekani says.

Is there a way out? Most analysts don't see the Left backing major reforms until it is securely returned to power after regional elections next spring in the Communist-led states of Bengal and Kerala. In the meantime, India could be missing a huge opportunity. Without more liberalization, much-needed foreign direct investment won't pick up, and job growth will be sluggish. If corporate earnings flag, those enthusiastic portfolio investors could take their money elsewhere. ■

–By Manjeet Kripalani in Bombay

GLOBAL WRAPUP

ISRAEL SHAKES UP ITS BANKING SECTOR

THE ISRAELI government hopes to get out of the banking business by yearend. On Sept. 13, **Finance Minister Ehud Olmert** announced he was putting 10% of **Bank Leumi** and an option for a further 10% on the block. The 20% stake will give the buyer control over Israel's No. 2 bank, with the right to appoint a majority of the board. The stake is worth more than $900 million at current market prices. Finance Ministry sources say groups from the U.S., Britain, and Israel are interested.

EU AND TURKEY: TALKS STILL ON TRACK

DESPITE FEARS that they would derail, talks on Turkey's accession to the **European Union** are expected to begin on Oct. 3 as planned. Analyst Kaan Nazli of New York's Eurasia Group consultancy predicts Brussels will launch the long-awaited negotiations on Turkey's accession even though Ankara has refused fresh demands to recognize the Greek Cypriot government first. Normalizing ties with Cyprus could be part of the talks, Nazli says. Cyprus has been divided since Turkey's 1974 invasion. The talks could take a decade—and may well bog down.

NEW RULES FOR MEXICAN VOTERS

FOR THE first time, some of the 10 million Mexicans in the U.S. will be allowed to vote by absentee ballot in next July's Mexican presidential election. About 4 million are eligible. But candidates can't raise funds overseas. Front-runner **Andrés Manuel López Obrador** canceled plans for a Sept. 15 U.S. visit after he was warned he might violate Mexican campaign laws.

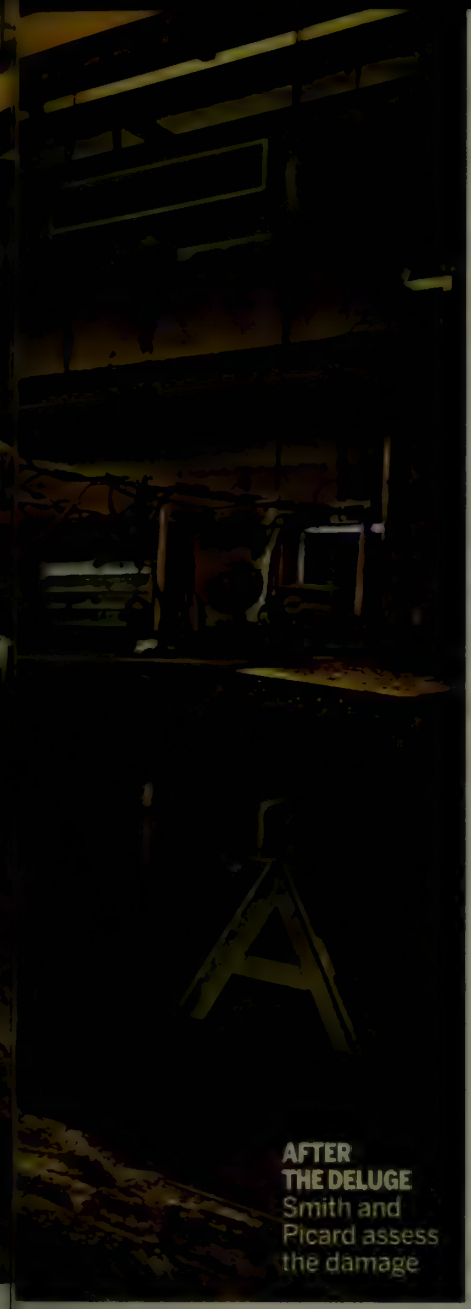
Turning the Tide

Textron managers and workers confront emotion, dislocation, and slime as they get New Orleans factories back online

KARLA COOPER'S HOME in Slidell, La., was spared the worst of Hurricane Katrina. Her family is safe and accounted for. But in her work life, Cooper, a 19-year veteran of New Orleans-based defense contractor Textron Marine & Land Systems and its human resources manager, is confronted by the vicious physical and emotional toll of the storm every day.

About 50 of the 1,150 employees at Textron M&L's two vehicle assembly plants—one in Slidell, and one in New Orleans—are still unaccounted for, two weeks on. More than 500 workers have nowhere to live. Each day, shell-shocked employees make their way to the Slidell plant—where Cooper and other managers work out of a makeshift, generator-powered office—just to make sure it still exists. "At the end of the day, I get home, I'm emotional," she says. Her voice breaks, just slightly. "You want to do something for these people, but there's so many. It gets to you. I get home and I just sit down and I'm exhausted."

As Cooper and the other beleagured managers at Textron's New Orleans plants—evacuees all—struggle to come grips with the destruction of their ci their homes, and their normal lives, th must also face the harsh reality that they don't throw themselves into a fu fledged business recovery effort, the may not be a New Orleans operation much longer. Already, alternate sites a being scoped out—although it's t strong preference of everyone from Te tron's Chairman and Chief Executi Lewis B. Campbell down to the G Coast line workers to keep the plan where they are. "We're losing sleep ov this," say B.C. "Clay" Moise II, New O



AFTER THE DELUGE Smith and Picard assess the damage

ans-based vice president for marine and ombat vehicles.

Cooper and her colleagues know all too ell that there are literally hundreds of ther businesses faced with Textron's ilemma. Each one that decides to relo- ate permanently would make a small, tinging cut to the economic and psycho- ogical well-being of the entire region. On personal level, it's a heavy burden for ooper, whose father worked at Textron, bear. "There are so many lives that are oking to you to get rebuilt," she says. nd that rebuilding, she knows, is going bring challenges that she and other extron managers have yet to imagine.

The urgency of getting Textron's New rleans plants up and running is felt on ll levels of management, and not just out f a simple desire for life as usual. Every- ne at the plants is very aware of the real fe and death issues here: Textron's two plants together make armored security vehicles (ASVs) for the U.S. Army. The hulls on the 23,000-lb. hexagonal steel beasts deflect explosions from improvised explosive devices in Iraq. Textron was making 30 a month for the Army before the hurricane, up from one per month a year ago. Now, they're making none.

A look at Textron's facility in East New Orleans makes clear the daunting task the company faces in the months ahead. At the plant, which houses a shipyard and the initial production lines for the ASVs, sheet metal has been ripped away from the walls and roofs, and everywhere the ground is covered in marsh grass and six inches of thick mud, the grimy residue of the 14 feet of water that practically swallowed the facility. Amid the crud, carcasses of snakes and nasty-looking, buck-toothed, three-foot-long swamp rodents called nutria lie among the wreckage of people's houses. Judging by the tracks, alligators have been making their way around the facility. A 65-foot wingnet shrimp boat rode the storm surge over the fence and sits outside a painting and sandblasting warehouse. "It looks worse than it is," says Jeffrey Picard, a 50-year-old Textron Systems senior vice-president sent down from division headquarters in Wilmington, Mass., six days after Katrina hit with the unenviable task of leading the recovery effort.

STRANDED

GETTING BACK ON TRACK isn't just a matter of making repairs. Employees are being paid a 40-hour work week, but the corporate office at Textron will not return them to plants in full force until the residue is tested for toxins. They've got it for the relatively unscathed Slidell plant, where final assembly of the ASV is completed, but it will be days before test results come in on the dank sludge scooped out of the East New Orleans facility.

Repairing the plants pales next to the task of housing 500 homeless workers

Even if the plant gets a clean bill of health tomorrow, Textron is struggling to figure out just where its employees will live. Early on, the company had snatched up five houses for its recovery team at $250,000 apiece in Denham Springs, La., a Baton Rouge suburb. Now, Baton Rouge is essentially sold out of ready-to-occupy property, both commercial and residential.

Many line workers, including Willie Ladner, 29, and his pal Willie Nicholson, 33, meanwhile, are essentially stranded. Their homes, like most others in their nearby Gulf Coast town of Bay St. Louis, Miss., were wiped away in the wind, water, and rain. The duo straggled into the Slidell Plant on the morning of Sept. 7. After the Red Cross and Army helped tend to their families' most basic needs in the immediate wake of the hurricane, the two men worried about their paychecks and insurance. They were relieved to learn that Textron is paying its employees, and that their health insurance will be honored.

In an effort to find workers a place to call home, Richard J. Millman, the division president in Wilmington, has six real estate agents out looking for anything—prefabs, trailers, RVs—that can be rolled in close to the plants. But nobody believes that the workforce will automatically return to full productivity once homeless employees get roofs over their heads. Many Textron employees—some of whom have lost friends, family, and loved ones, in addition to homes—are likely to suffer from post-traumatic stress in coming weeks.

Another huge question mark that Picard and his team must contend with is when the city of New Orleans' infrastructure—power, running water, public transport—will be able to accommodate a workforce. Outlying parishes began allowing evacuated citizens back in as early as last week, and towns such as Slidell are slowly starting to power back up. But it is anyone's guess when the hardest-hit parishes, St. Bernard and Orleans, where 28% of Textron Marine & Land workers called home, will begin to recover from the catastrophe.

Confronted with such dire circumstances, Picard has leaned hard on his team, setting an admittedly quick timetable for recovery goals that makes for a dizzying post-hurricane rush. Immediately after the storm, Picard commandeered space in a Textron fluid-pump repair plant in Baton Rouge to use as a staging area. Since the entire 504 area code was knocked out of service, he had the company set up an 800 number for employees to report in and get information. That was a huge help, but workers in particularly hard-hit areas were symied by the lack of phone service. "It's like we got broken legs," says Nicholson. "We can't communicate with anybody."

By Tuesday, Picard and Millman, his boss, assigned each New Orleans manag-

er a counterpart from New England to relieve them of the additional stress of decision-making while dealing with their own personal evacuation and damage-control. "The knowledge was in their minds, yet initially you can imagine where these folks' heads were," Picard says. "[We tried to] take that burden off them."

By Wednesday, Aug. 31, two days after Katrina, managers in New England were squawking twice daily with whatever New Orleans employees they could find. Helicopters borrowed from Textron unit Bell Helicopter flew over the plants for an initial damage assessment. The aerial surveillance missions continued nearly every day for more than a week—and brought supplies to weary security guards who rode out the storm.

"ARDUOUS AND GRIEVOUS"

ONE OF THE MANAGERS who spent a lot of time in the sky commuting back and forth between Baton Rouge and the plants was Moise. The day before the storm, he had fled his house in Old Metairie, La., with his wife and kids. After hastily poring over a lifetimes' worth of stuff, they packed what they could into Moise's Ford truck and were on their way to Houston to wait out Katrina.

Moise is a broad shouldered, 49-year-old Louisiana native, a University of New Orleans grad, makes his roux with bacon grease—and he's clearly struggling with how to balance his loyalty to the company with his loyalty to the region. While he is committed to keeping the plants where they are, he knows that it may not be possible. "If we elect to move, trust me, it is going to be a very arduous and grievous decision-making process," Moise says. "These people need this—that's what continues to go through our minds. Without this, what would they turn to? How do they get shelter over their heads?"

Sentiment had little place in Moise's consciousness as he fought to get his plants up and running. Driving back from a survey of the East New Orleans site, which still looked tattered 10 days after the storm, he listened to dazed survivors call in and recite the names of loved ones on the radio. A young woman gave t name, phone number, a address of her yet-to-l found grandmother Chalmette, La., a particul ly devastated town, and other asked if anyone h seen a relative in the inu dated Lakeview section New Orleans. Moise turn the radio off with a disda ful flick of the hand. "T whole point of the analysis is to take or minimize things such as emotions a gut feeling." Moise adds: "It needs to that way."

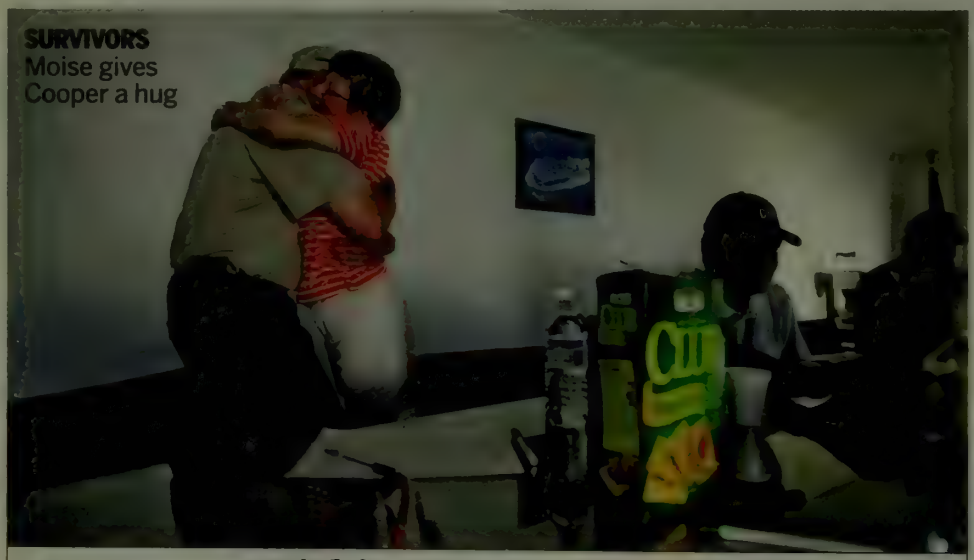
Textron's strongest reason to stay put is an experienced work force

While several managers worked to store the plants, Picard and J.O. Smi New Orleans-based executive director operations, diligently inspected oth production sites capable of taking on t ASV work, such as Army depots in cent Texas' Red River Basin and Annist Ala. Alternate sites have to be consider from a business perspective, Picard sa And from a rational business perspecti what makes sense temporarily cou very well make sense permanently. B the workers in Louisiana have at le one thing going for them, apart from t company's loyalty: Picard worries a gr deal about quality issues that would ar in training a brand new workforce make a complex vehicle like the AS since much of the manufacturi process isn't automated.

All of the Textron Marine & La managers want more than anything get the ASV line back into production. has become a high-growth gem for Te tron, expected to kick up $450 million the company's $10 billion top line ne year. Just 13 days after the storm, Pica watched over the Slidell assembly pla on an active Saturday morning. Hu fans thrummed, powered by generato shipped in a day before, and worke with power washers blasted the last the gunk off the floors. Just days befo water covered the ground and deb dotted the assembly line. He got as clo to giddy as he could about a ne makeshift cafeteria to feed clean workers. East New Orleans is still mess, but here production is expected start in a matter of days.

Picard has traded in the dress slac and shirt from earlier in the week for untucked golf shirt and cargo shorts. he surveys the plant, he muses, "It loo different, now, doesn't it?" ■

–By Brian Hin in Slidell, L



SURVIVORS Moise gives Cooper a hug

Picking Up the Pieces

With two crucial plants in Katrina's path, Textron Corp.'s Marine & Land Systems faces an epic rebuilding job. But getting its workforce up and running again may turn out to be an even harder task.

1,150	50	500	5
WORKERS	**MISSING**	**DISPLACED**	**PURCHASES**
Total number of employees in the Katrina zone	Approximate number of workers who are still unaccounted for	Approximate number of Textron employees who lost their houses	Number of houses bought for executives leading the recovery effort

Data: BusinessWeek, Textron

www.scm.com.ua

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Crawling Out Of the Wreckage

Gulfport's Hancock Bank had planned for Katrina—and foresees a rebuilding boom

WHAT'S IT LIKE TO run a 103-branch bank using cell phones, white boards, and borrowed furniture? Ask executives of Hancock Bank in Gulfport, Miss. Its once-plush 15-story headquarters, sitting just a quarter mile from the Gulf of Mexico, was shattered when Hurricane Katrina sent a 30-foot wall of water crashing through the lower floors.

Now, with the verve of a startup and like so many storm-ravaged businesses, Hancock is determined to reopen. "We see ourselves as an essential service, just like hospitals and drugstores," says Vice-Chairman and Chief Executive George A. Schloegel. He and his staff are operating out of temporary digs in the bank's former training center three blocks away. Across the street lies the city's makeshift morgue, which as of Sept. 13 was still receiving bodies. The walls of the stand-in offices are plastered with notes offering everything from baby-sitting to generators; the bank has rented apartments for those among its 2,000 employees who had to abandon their homes.

At the new headquarters, staffers are mostly nourished by granola bars and Gatorade. For nearly two weeks there was no running water, and even now the place is overcrowded, so three Porta Potties remain outside. Some executives sit at card tables in dimly lit rooms approving multimillion-dollar reconstruction loans. During the second week, a few set up shop in the parking lot of a Wal-Mart 20 miles north of Gulfport. Other employees are trying to get power back on at branches and to communicate with those who had to flee the storm or the chaos that followed. "We're so excited," says Joy L. Phillips, Hancock's general counsel. "We just got fax service."

On four giant white boards, bank executives have sketched out the state of all 103 branches: 80 are back in operation, although in some cases that's a generous description. As for the four locations in New Orleans, bright red X's show that all services are still down.

Schloegel and his team followed the company's drill for disaster recovery. With $4.7 billion in assets and branches throughout Florida, Louisiana, and sissippi, 106-year-old Hancock Bank local institution in a region regu pounded by storms. Years ago bank ex tives developed a hurricane plan to pr crucial data. In this instance, they tra Katrina for a full week before it hit the Coast. Back-office staff in Baton R went on alert. Then, the Friday before storm hit, more than 200 backup t containing all the bank's records shipped to Chicago, where they were on secure servers. "We anticipate h canes—and pulled the trigger," says C Financial Officer Carl J. Chaney.

DRYING OUT Water surged 30 ft. high

$15 MILLION IN QUICK CASH

STILL, HANCOCK WAS a wreck: 75% o branches were knocked out by the sto six may have to be rebuilt altogether. W power out, cash machines were usel and business clients could not electr cally deposit pay checks into workers' counts. But Schloegel, a gruff Gulfport tive who has run Hancock since 19 refused to close up shop, even tempora He persuaded Federal Reserve official Birmingham, Ala., to send down $15 m lion in cash in an armored truck on Aug to bolster reserves while the power out. That covered the payroll for the lo school system, trucking companies, a the sheriff's department. With some se blance of order n restored at the ba Schloegel has homeowners s this month's m gage payments.

> The CFO says the economy is going to "explode"

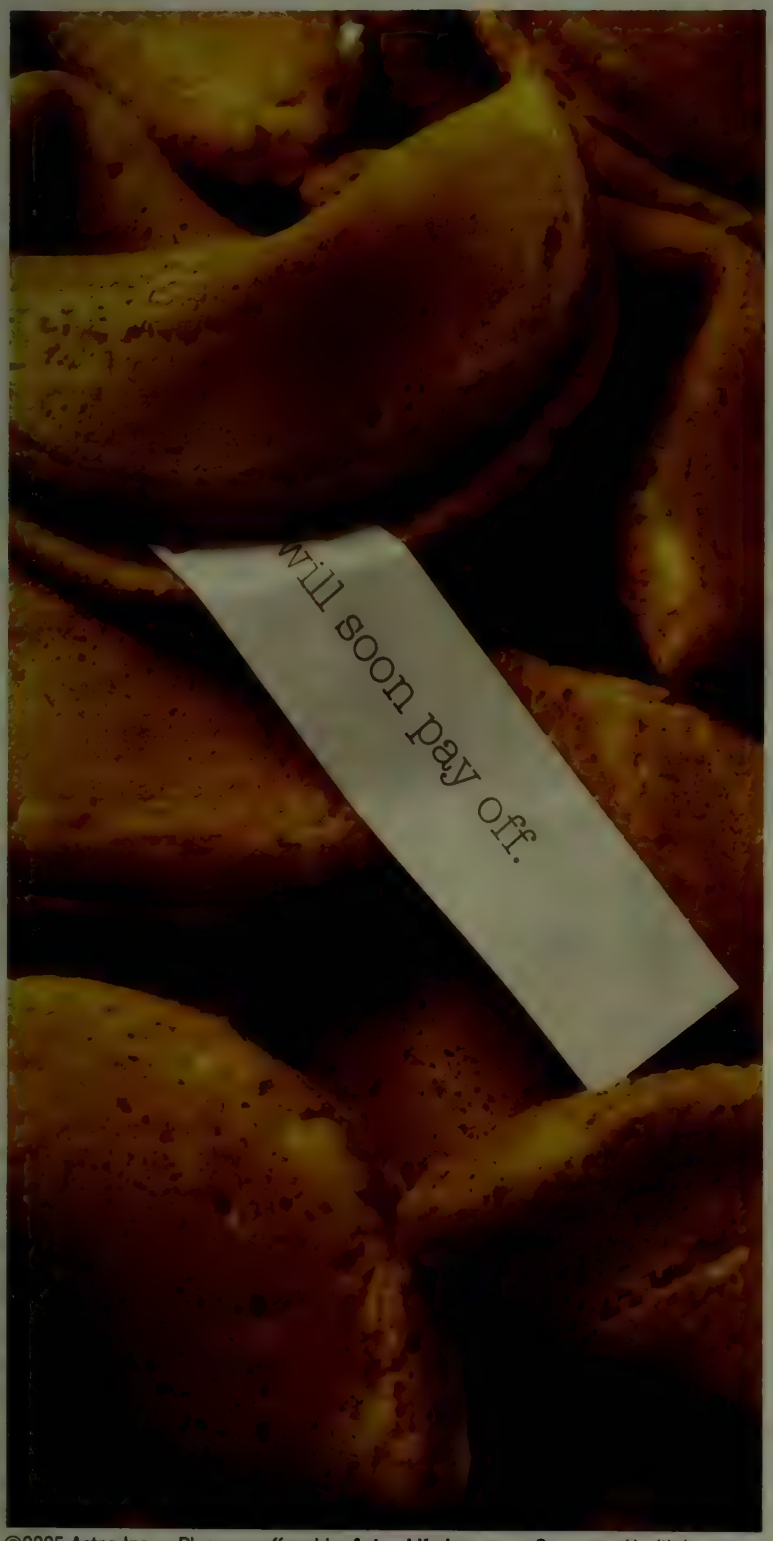
Bank executi readily admit su friendly machi tions—along w the reconstructi of Gulfport—co prove a boon. After Hurricane Camille Gulfport in 1969, Hancock saw a storm business. Its assets grew 43% in fo months. Already, there are indications t Katrina may do the same. On Sept. 7 t bank arranged $2.7 million worth of n loans, all closed by weary underwriters that Wal-Mart parking lot. Since then, a cal company took out a $5 million lo "We feel very comfortable that the econ my is going to explode," says Chaney.

On the streets of Gulfport today, N tional Guard soldiers direct traffic, a crews clear debris. Work has started rebuilding Route 90. But Hancock Ban headquarters, once Gulfport's tall building, has been gutted. It won't habitable for another year. ■

–By Brian Grow in Gulfport, Mi

We want you to know

The Importance of Information



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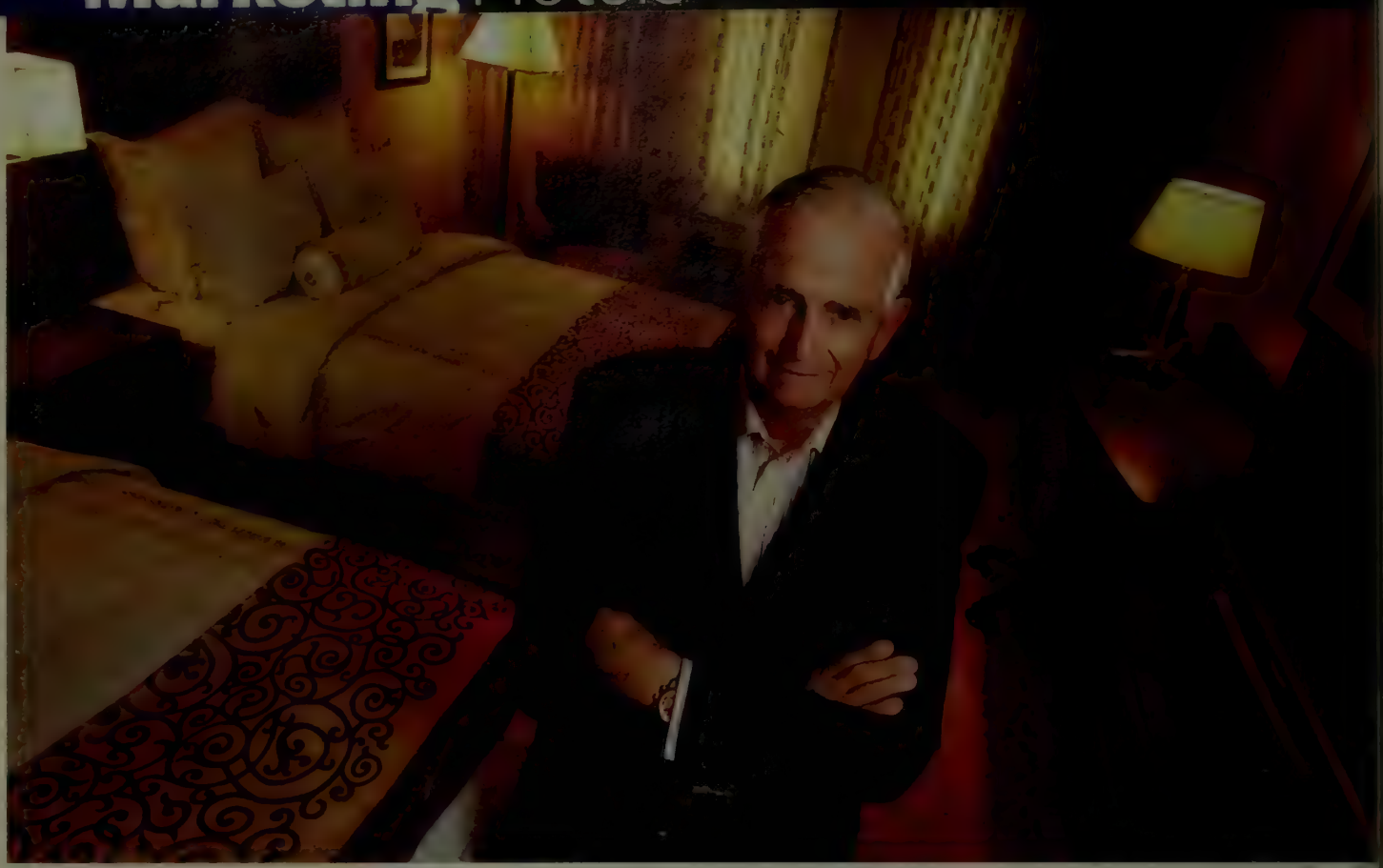

CEO MARRIOTT Will a new deco reach beyond t wing-tip crowd

Marriott Hip? Well, It's Trying

The chain has long been known for service. Now it wants to be stylish, too

MARRIOTT CEO J.W. "Bill" Marriott Jr. hated an ad shown to him a few months ago for an upcoming hotel campaign. "Put some wing tips on that guy," the 73-year-old barked at the picture of a sandal-clad hotel guest. "You wouldn't wear sandals to see IBM." Marriott's son John, 44, executive vice-president for lodging, shot back: "You might if you were seeing Microsoft." After a few lively rounds about the new direction of the Marriott brand as it woos young travelers, the elder Marriott relented and greenlighted the concept.

Marriott International Inc. has always ranked high among the wing-tip generations embodied by Bill Marriott and his eldest children. But now, after half a century, the Bethesda (Md.) 2,700-hotel chain is in the midst of a major brand makeover to attract the business-casual, iPod-playing travelers who view Marriott as the sensible shoe of hotels. "We're not appealing to Generation X , even though we have a strong bond of loyalty with the baby boomers," says Marriott.

Adapting to a new zeitgeist doesn't come naturally. Rival Starwood Hotels' trendy W Hotel chain may be drawing customers with Philippe Starck-like postmodern design, but Marriott has stubbornly focused on a basic culture of service begun in 1927, when the CEO's father opened a root beer stand in Washington, D.C. "In an era of buzz, Marriott is almost an anti-buzz company," says Joe Brancatelli, publish of travel Web site JoeSentMe.com.

Step by step, though, the hotel giant marching into the future. On Sept. Marriott introduces a newly remodel hotel room for its flagship hotels with glass-enclosed replica in Times Square a backdrop for music and comedy a and even a wedding that will be captur by entertainment news cameras ov four days and broadcast on Westwo One radio. This follows the recent laun of a new outdoor and airport ad ca paign aimed at road warriors obsess with productivity, featuring arresting i ages of athletes leaping out of bed; t slogan is "Revive." It's all part of the n Marriott being hatched by young bra execs recruited from Nike, Procter Gamble, and Coca-Cola. "We want to from being a logical choice to a bra that's loved," says a hopeful Michael Jannini, Marriott's top executive brand management.

Marriott is trying not to be a hostage its own traditions. When Starwood H tels' Westin introduced its "Heave Bed" redesign six years ago, CEO Marri scoffed that it looked like "a hospi room." But two years ago, after checki

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into the independent James Hotel in Scottsdale, Ariz., Marriott, who tours 300 hotels a year, saw that white duvets, piles of pillows, and flat-screen TVs commanded premium rates at what was merely a converted motel. He ditched his dowdy floral bedspreads and persuaded franchisees to spend more than $1 billion to update all 628,000 beds worldwide by yearend 2005. At flagship hotels first and then Renaissance Hotels, it's offering high-tech panels featuring high-definition TV to use along with laptops, iPods, and other plug-ins.

PLAYING CATCH-UP

MARRIOTT HIMSELF is no early adopter of new trends. He has an iPod, but the younger Marriotts upload his Tommy Dorsey tunes for him. Still, the patriarch doesn't let his personal tastes get the better of the brand—witness the approval of the sandal-clad traveler in his ad. "He won't touch sushi, but he's a big proponent of sushi bars," says Robin Uler, Marriott senior vice-president for global food and beverage. And now, after watching the rise of Starwood's W hotels, Marriott is deciding whether to launch his own "designer" chain. But, concedes the CEO, "it can't have a Marriott name on it" if it's to appeal to the in-crowd. Although Marriott is clearly playing catch-up, rivals are watching closely. "I think it's good for Marriott. I'm just glad we got a five-year head start," says former Starwood Chairman Barry Sternlicht.

New managers are bringing new methods. Senior Vice-President Sid Yu, 42, a former Nike strategist, hooked up Marriott with hot design firm IDEO, which sent a team of anthropologists and architects to tail Marriott guests. They observed that while hotels obsess about a smooth check-in, the big moment for travelers occurs upon entering their rooms. Marriott is exploring how to enhance that "exhale moment," says IDEO designer Fred Dust. "Maybe a little light shining on a small welcoming gift?"

Studying marketing and service philosophies outside of hotels is also yielding changes. Marketing managers went to Manhattan almost every weekend for a year to scout boutique hotels, restaurants, and retailers. Team member Yvonne Bean, 42, noted that after ringir up a purchase at Nordstrom, clerks wa around the counter to hand the bag to th customer. From that idea, Marriott has r designed Courtyard's desks to open up s clerks are closer to guests. "We need compare ourselves to the experienc people have in every other aspect of the lives," says Bean. In a nod to Starbuck Marriott is also transforming humdru Courtyard lobbies into "great rooms" f those who prefer inviting public spac for working to holing up in their room Those changes have already begu rolling into Courtyards and are bein looked at for Residence Inns and others

The effort may smack of General Mo tors Corp.'s "Not Your Father's Oldsme bile" approach, but Marriott, althoug late to the makeover party, is hardly weal In the second quarter, its North America hotels posted an 11.2% increase in rev enues per average room, compared wit 9.4% at Hilton Hotels, according to Cit group. It has minimal exposure to Hurr cane Katrina, and earnings are expecte to grow 17% to 22% a year through 200 Marriott is spending about $20 million year on the transformation strateg while franchisees pay for the upgrades.

One complication with its plans: Ma riott owns just seven of its hotels whil managing or franchising the rest, con pared with Starwood, which owns 137, 19%, of its hotels. So Marriott has had t persuade franchisees to shell out for a the changes, which has sparked con plaints. "Marriott is like other brand with initiatives that create no value fo franchisees," gripes John M. Dunn, CE of Dunn Hospitality Group Ltd. i Evansville, Ind., which owns and man ages Marriott and Hilton hotels, amon others. But even Dunn concedes, "Fro a service standpoint, Marriott's standard are unparalleled."

But Marriott had little choice but to ac Its research showed that only 31% of trav elers viewed Marriott as their top choice i 2004, down from 36% in 1999. By 201 Gen Xers—those born in the late 1960 and in the '70s—Marriott's big challeng will make up 66% of potential guests fo all hoteliers, up from 33% today. Tru there's a risk in chasing stylishness: Ma riott could lose focus and slacken its fa bled attention to service and reliabilit But that seems unlikely. Even as Marrio switches to white duvets, it still make sure each housekeeper studies i decades-old handbook outlining the 10 steps to clean a room the Marriott way.

–By Catherine Yang in Bethesda, Md with Diane Brady in New Yor

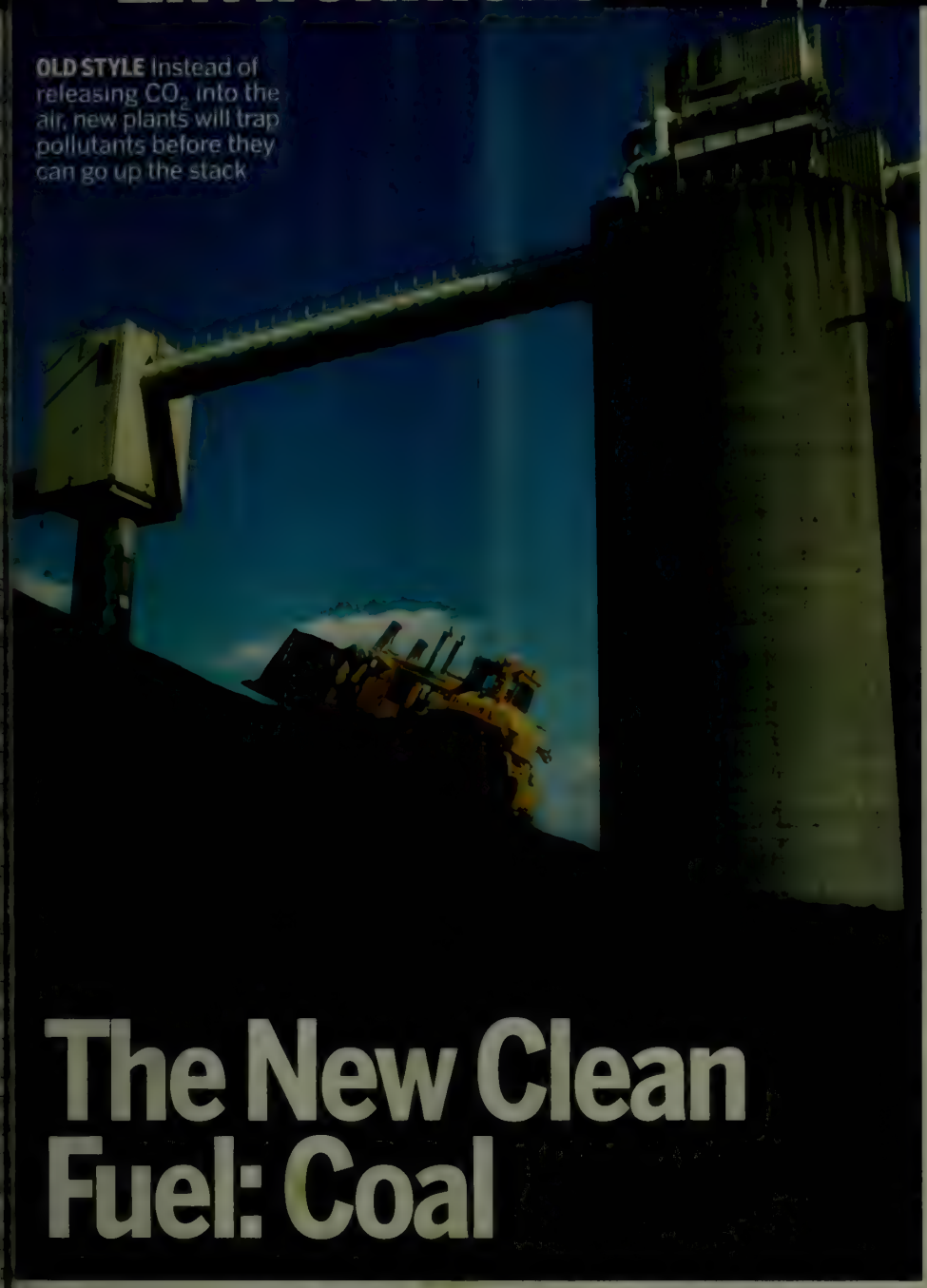
A Post-Modern Marriott

ROOMS Gone are floral bedspreads—now replaced by minimalist white duvets or triple-sheeting. Premium linens at top-end hotels, more powerful shower heads, music, mood lighting, and redesigned furniture.

PUBLIC SPACES Relaxed and expansive rooms with food and beverages and a business library replace the little-used traditional lobby at Courtyard By Marriott, encouraging wine and coffee sipping while working on laptops à la Starbucks.

TECHNOLOGY Beyond high-speed modems and Wi-Fi, business travelers are getting 32-inch flat-screen, high-definition TVs that allow users to split screen between the TV and their laptops, plus plug-ins for cameras and iPods.

IT'S MORNING AT MARRIOTT The "Revive" ads are a big leap



OLD STYLE Instead of releasing CO_2 into the air, new plants will trap pollutants before they can go up the stack

The New Clean Fuel: Coal

American Electric Power, once the nemesis of greens, may show the way

AMONG ENVIRONMENTALISTS, American Electric Power Co. has long been the enemy. With two dozen coal-fired power plants from Appalachia to the Piney-woods of northeast Texas, the utility burns more fossil fuels than any other U.S. company, consuming an average of 1,000 train-car loads of coal every day. Despite new smokestack scrubbers, it also coughs out the most pollutants, including compounds that form acid rain and smog, toxins such as mercury, and gases thought to hasten global warming. "They are a very dirty company," says Bruce E. Nilles, Midwest representative of the Sierra Club.

Now, AEP Chairman and Chief Executive Michael G. Morris wants to construct at least two more coal-hungry plants along the Ohio River—but this time environmentalists are wishing him Godspeed. Morris is breaking with other utilities, and with AEP's past, to embrace an eco-friendly way of producing electricity from coal. These facilities would be as clean as gas-fired generators from the get-go, no matter how impure or sulfurous the coal is. And they could be retrofitted easily to eliminate emissions of carbon dioxide, the chief greenhouse gas. "Let's take this to the next level—that's what we're doing here," says Morris.

A BOOST FROM REGULATORS?

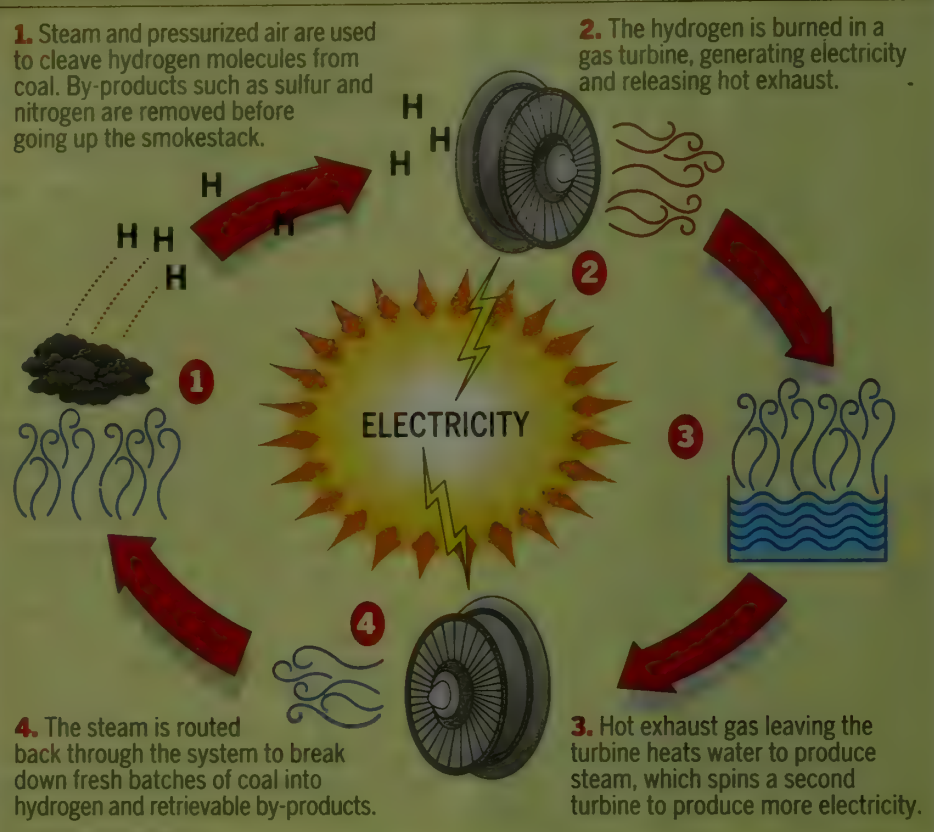
THAT NEXT LEVEL comes at a price. AEP figures the plants, which would transform coal into a nonpolluting synthetic gas, would cost nearly $1.2 billion apiece to build. That's 20% more than a conventional coal-fired facility with the same capacity and almost four times as much as a similar-size generator fueled by natural gas. The energy bill that President George W. Bush signed in August could cover some of that by providing tax credits and subsidies for clean-coal projects. The Columbus (Ohio) utility wants to collect the rest from consumers through higher rates and is awaiting action by Ohio regulators. Approval is no sure thing, though. In late 2003, Wisconsin's Public Service Commission rejected plans by Wisconsin Energy Corp. for a coal-gasification plant because of its higher price tag and untested technology. As a backup, AEP has picked out sites in West Virginia and Kentucky.

If regulators side with AEP, it could lead other power companies to make the switch. That could boost clean-coal technology from the pilot-project stage, where it has been stuck for more than a decade, to full commercialization. Since these plants wring out pollutants instead of sending them up the chimney, their wider use could reignite demand for high-sulfur coal, which has been in decline since the Clean Air Act of 1970, and thus return jobs to the coal basin in the rural Midwest. Indeed, AEP's impact may reach all the way to China, which is facing global pressure to clean up its growing fleet of coal-burning generators.

To environmentalists, the biggest plus relates to climate change. Instead of blowing CO_2 into the atmosphere, where it traps heat. The new design could one day extract the gas from the chemical reactor and then "sequester" it deep underground. That would allow power generators to stick with coal even if the U.S. joins other industrialized nations in cutting carbon emissions, notes Jana Milford, a senior scientist at advocacy group Environmental Defense. Daniel A. Lashof, science director for the Natural Resources Defense Council's climate center, agrees:

LOOK, MA, NO SOOT

American Electric Power is planning the first commercial-scale plants that would extract a clean-burning gas from dirty coal



Data: American Electric Power

"Gasification is the future for coal-fired power plants."

The building project is only part of Morris' cleanup plan. Since taking over as AEP's chief in January, 2004, he has pledged to reduce the $14 billion utility's CO_2 emissions by 6% by 2010, in part by upgrading old, inefficient plants and by substituting wind power. A biologist whose first job was preparing environmental impact statements, Morris, 58, also has promised to spend $3.5 billion to lower emissions of other pollutants, such as sulfur dioxide.

Utility analyst Justin C. McCann of Standard & Poor's says Morris' environmental emphasis helps investors in two ways. Because coal-gas plants are more efficient, they should lift earnings by $175 million when they're online in 2010. These efforts also might keep greens from pushing for more costly investments. Morris says he has little choice if AEP wants to get a full 40 years of output from its new plants. Carbon-emission mandates are inevitable, he says, noting: "We are a coal-based utility."

If the alliance between AEP and environmentalists is surprising, so is the comeback of King Coal. As cheap and abundant as dirt, coal was always the power industry's favorite combustible. Electricity generators burned a record 1 billion tons of it last year, accounting for 50% of the nation's power supply. And after 2005's scorching summer, they're on track to top that handily this year. But while the Energy Dept. was dishing out more than $100 million a year on clean-coal projects, utilities began turning their backs on coal in the 1990s, opting instead for natural gas, which was almost as cheap and didn't require huge capital investments for emission controls. From 1999 to 2003, the nation added 133,600 megawatts of gas-fired generating capacity, vs. 500 megawatts for coal.

But that collective rush boomeranged on power producers as gas prices doubled, and then doubled again. All of a sudden, with electricity consumption climbing and most utilities still afraid of the nuclear option, coal looked like a bargain again. The Bush Administration fanned the trend by adopting less stringent requirements on mercury emissions—power plants are far and away the No. 1 source of the airborne contaminant—and by repudiating the Kyoto Protocol, which binds signatory nations to reduce emissions of CO_2 and other greenhouse gases. The latest tallies show that at least 115 coal-fueled plants are at some stage of construction in the U.S.

Renewed demand for coal could create jobs in the rural Midwest

INTEREST HEATS UP

MORRIS WANTS TO make sure that at least a few of those use the new gasification techniques, which begin by breaking coal's hydrocarbon molecules apart in an industrial-size pressure cooker, and then burn the gas to run a series of generators (table). The new plants still produce CO_2, which would go out the smokestack. But if the government imposes greenhouse gas caps, this, too, could be siphoned off and contained.

The U.S. has two small-scale coal-gasification plants now: a 265-megawatt generator outside Terre Haute, Ind., owned by Cinergy Corp., and a 260-megawatt generator in Tampa owned by TECO Energy Inc. Both opened in the mid-1990s and were heavily subsidized by the Energy Dept. under its clean-coal program. Now, Cincinnati-based Cinergy has announced plans for another coal-gasification facility in Edwardsville, Ind., that would be more than twice as big. Southern Co. and startup Excelsior Energy of Minnetonka, Minn. are lining up funding for full-scale plants, too.

Before Morris came over from Northeast Utilities, AEP might have been content to let others play pioneer. "If you look at power companies that were environmental leaders over the last 10 or 20 years, AEP would not be toward the top of the list," says David G. Hawkins, director of the NRDC's climate center. Morris credits his environmental streak to his college days as a biology major and to his first job at a landscape-scarring coal mine in Indiana. Today mines like that often are reclaimed, he says, pointing to the Wilds, a 10,000-acre refuge in Ohio for African animals on what had been an AEP mine. "We aren't your father's coal burners or coal miners anymore," says Morris. Indeed, it may be dirty old AEP that proves that clean coal isn't an oxymoron. ■

–By Michael Arndt in Chicago

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[1] One Rack of Sun Fire X4100 Servers populated with Dual-Core AMD Opteron processors can take as much as 56% less power on average than the Intel Xeon MP processor-based server solution required to provide a similar amount of CPU cores.

IT'S A WHOLE NEW WEB

AND THIS TIME AROUND IT WILL BE BUILT BY YOU

DANEANE GALLARDO DOESN'T JUST SURF THE WORLD WIDE Web. She lives on it. Every day, she wraps herself in her own personal electronic cocoon of e-mail groups, instant messaging, blogging, creating Web sites for indie musicians, and much more. "Tomorrow I'll try something new," says Gallardo, a former Borders Inc. bookstore manager who coordinates Web site development work at software startup Indimensions Systems Inc. in Kitchener, Ont. "I stopped watching TV a month and a half ago. If I didn't have to eat, pee, and have sex, probably I'd have no need for the 3-D world."

O.K., so this self-described "sick Mac freak" clearly has plunged a wee bit far into the Internet's deep end. But she's on to something that's about to dawn on the rest of us: A whole new Web is emerging from the wilds of cyberspace. It's no longer all about idly surfing and passively reading, listening, or watching. It's about doing: sharing, socializing, collaborating, and, most of all, creating. Says Eckart Walther, Yahoo! Inc.'s vice-president for product management: "It's the second coming of the Web."

And this time, it's Your Web. No longer content to be merely viewers and consumers, people increasingly are taking an active part in creating their online lives. With its longtime tagline, "The network is the computer," Sun Microsystems Inc. made the case that computing transcended hardware. Sun President Jonathan Schwartz thinks another crucial shift is under way: "The network is now *your* computer."

At many new Web sites and services, the creative energy of countless souls virtually crackles off the screen. They're cobbling together their own services from customizable Web sites and Lego-style pieces of Web software. By the millions, they're gathering and disseminating their own news with blogs and podcasts, creating customized article and photo feeds from their favorite sites and even annotating them with helpful te tags that others can search for on the Web site del.icio.us (pag 82). They're producing their own entertainment on video, s cial-networking, game, and photo-sharing sites such as Yahoo Flickr. At MySpace.com, some 21 million monthly visito spend up to several hours a day sharing their thoughts, photo and music with friends on personalized home pages. Ditto Cyworld, which claims almost a third of South Korea's 48 mi lion people as members (page 80).

"The Web isn't so much a place anymore," explains Ro Mayfield, CEO of Palo Alto (Calif.)-based startup Socialtext In which offers services to create collaborative Web sites calle wikis. It's more of a doorway into services, from the user-wri ten reference site Wikipedia to the community organizing ser ice Meetup to the folksy classifieds site Craigslist. As Mayfie noted in a recent blog post, "They Google, Flickr, blog, co tribute to Wikipedia, Socialtext it, Meetup, post, subscribe, fee annotate, and above all share. In other words, the Web is i creasingly less about places and other nouns, but verbs."

Harnessing Change

THIS POTENT NEW DO-IT-YOURSELF trend is shaking up a ra of industries, from software and telecommunications to medi marketing, and entertainment. As people individually and co lectively program their own Web, they're increasingly calling t shots. In the process, they're challenging the way media orga izations cover and distribute news and entertainment, the wa advertisers target pitches at them, and the way tech compani design and sell their products and services. Most of all, they' rapidly changing their minds about what they will pay for an

how. That's disrupting long-established business models, from newspaper subscriptions to television advertising.

These sweeping changes are why *BusinessWeek*'s first-ever Best of the Web Special Report is full of names that may be unfamiliar. The group blog PostSecret lets people reveal their innermost thoughts in often poignant mock postcards that add up to a community art project (below). At DonorsChoose, schoolteachers post requests for resources they need, and visitors can choose which they want to fund, helping to raise $3.9 million for 223,000 students (page 86). In the spirit of Your Web, we also took a stab at tapping the wisdom of the online crowds. Our survey drew more than 16,000 responses—and a lot of great tips, such as the collaborative tech news site Digg.com and the tasteful shopping blog MightyGoods.

The new imperatives of Web 2.0, as many call it, will present challenges not only for Web giants such as eBay, Yahoo, and Google but for some of mainstream tech's biggest leaders as well. That's because these new Web services are rapidly erasing the line between the Web and desktop software. "Applications are no longer software artifacts," notes Net pioneer Tim O'Reilly, CEO of tech publisher O'Reilly Media Inc. "They're ongoing services."

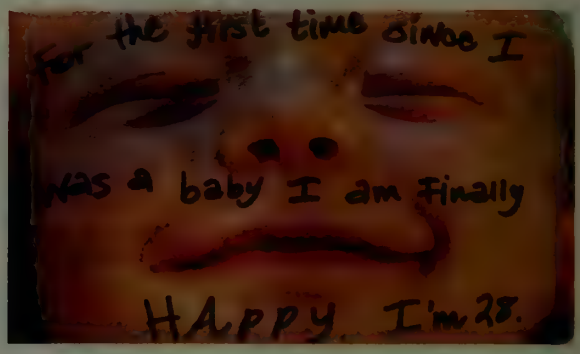
As a result, even software king Microsoft Corp. is seeing core franchises such as its Office software attacked by Web mail services, wikis, and JotSpot Inc.'s do-it-yourself software tools, which let you quickly create customized mini-programs such as a shared to-do list for a corporate department. As a result, the We is even starting to challenge Windows as the foundation o which people are creating software—which is now morphin into services on the Web.

Certainly, the participatory nature of Your Web presents ne opportunities for savvy tech suppliers, too. The nimblest one are already harnessing their customers' expertise, open sourc software-style. "We're starting to see our customers build ne applications on their own, on top of our platform," says Mar Benioff, CEO of Salesforce.com Inc., which sells Web servic for salespeople to manage customer relationships. In fact, it r cently debuted a plan for an online marketplace for corporat software that runs with Salesforce's service (BW—Sept. 19).

Power Tools

OTHER INDUSTRIES MAY have a tougher time than tech. Medi and entertainment companies, which have profited by becomin gatekeepers, sit right in the crosshairs of Web do-it-yourselfer After all, who knows better what you like than you? If you can us the Web to find exactly the service, article, video, or podcast yo want—and maybe even create it yourself, or with friends—wh needs networks or newspapers or (gulp) magazines? That's wh sites and services as varied as your favorite blog or podcas Google, Craigslist, and MySpace are stealing subscribers and ac

CONTENT
VOICES OF THE PEOPLE



POSTSECRET
Confessions, comic and serious

FOR TENS OF MILLIONS OF OFFICE WORKERS, WEEKENDS AT home mean a chance to recover from five business days of staring at a computer screen. But these days the Web is brimming with so much creativity—art, music, photography—that online visits can feel more like a stroll around Soho than overtime at work.

What gives these new sites their spark is audience participation. More and more, the role of the entrepreneur is to come up with a concept and then open the doors to all comers. On many of these sites, whether it's an art site like PostSecret or a photography club like Flickr, the public provides all of the content. Without the users there would be nothing to click.

If you're in a strolling mood, a good place to start is PostSecret (postsecret.blogspot.com). Every day, hundreds of people illustrate and caption their confessions on postcards and send them to an address in Germantown, Md. There an art and pop culture lover named Frank Warren picks out the best and posts them on his site.

Whether they're true or dreamed-up, these confessions are a delight for amateur shrinks and fans of popular culture, not to mention voyeurs. The captioned artwork careens between poignant, nasty, and hilarious. This combo has rocketed PostSecret to the 10th most-popular position of the 13 million blogs monitored by Feedster.com, a blog search engine.

Some of the secrets in PostSecret are comical. On a Starbuck cup, one reads: "I give decaf to customers who are rude to me. Others are dead serious. Next to a drawing of spotted pin lungs: "Sometimes I wish I had lung cancer s my Mom would quit smoking."

Many of the new music sites feed off of the audiences, too. While Internet services in th past have provided streaming music by genre from rockabilly to grunge, the new sites enab users to custom-build their own channels. Or of the slickest sites is Pandora. The three-weel old site invites listeners to type in a few favori artists. Then it plays a selection of songs th matically or musically related to those choice

Don't like a song? Click the thumbs dow icon, and the service tweaks your profile. Oth clicks lead users to buy the song at iTunes Amazon.com, or to share their mixes by sen ing them in e-mails to friends. If you wond

For its Best of the Web Special Report, BusinessWeek Online asked readers to vote for their favorite Web sites and services in 29 categories, organized into 5 groups ranging from Work to Play. More than 16,000 votes were cast. The numbers shown in the following tables are the percentage of voters who named the site as their favorite. Unless otherwise noted, the sites are the name listed, plus ".com"

The Coolest, Hottest, Smartest Web Sites

Pick of the Web Litter: A wealth of intriguing new sites and services can be found by venturing beyond the mainstream. Take a look at our choices for the best of the new Web.

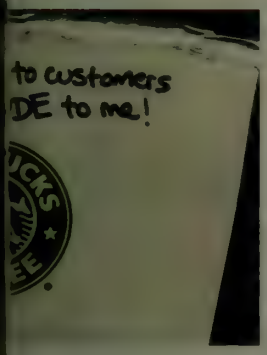
More Work to Do: For all of the cool new stuff out there, the Internet remains a daunting place for many people. Jakob Nielsen, a Web design guru with Nielsen Norman Group, tells what needs to be done.

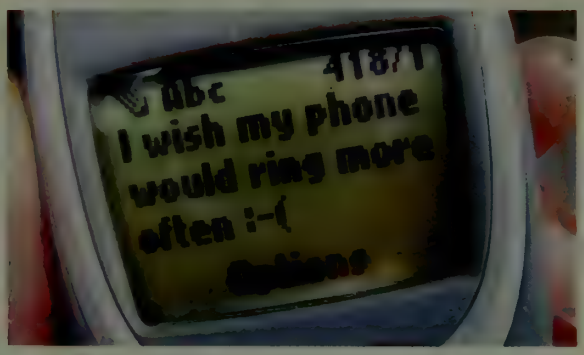
BusinessWeek online

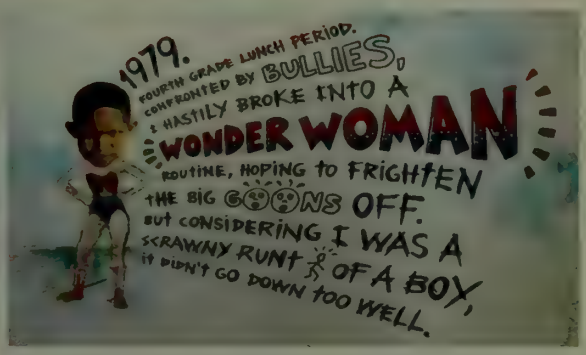
www.businessweek.com/extras

rtisers alike from traditional media, newspaper classifieds, ra-
, and television. Says Yahoo Chief Technology Officer Farzad
zem: "It's not about mass media, it's about My Media."

One reason all this is coming to a head now is the maturing a host of Internet technologies. Really Simple Syndication, or S, lets people subscribe to blogs and other sites, so they get stomized bundles of material sent to them as they're creat-—say, all the stories about Hurricane Katrina from *The New rk Times*. A set of programming technologies collectively bbed Ajax is also ending the World Wide Wait, making Web plications almost as fast as traditional desktop programs.







y a track was selected, the service will explain. A Talking ads listener recently received a song by guitarist Mike Stern cause it had "a contrapuntal melodic presentation, groove-ented approach, and quirky ideas." Pandora's downside? It's t free. Listeners can try the service for 10 hours, before pay-g a $3 a month charge.

A similar free site is Mercora. In a recent test, its connection emed a bit more tenuous, but it boasts different features. Users, for example, can record some music for later listening. One important distinction: The songs on these services are not downloaded files that can be made into CDs or loaded onto iPods. They're for listening on systems connected to computers.

Of the photo sites, Flickr.com, which was bought by Yahoo! earlier this year, offers an astounding selection. Type in one word, Katrina or Iraq, and you'll see photos taken there within recent hours. Flickr.com is the eyes of the world on one site, and (page 88). Some enterprising folks are playing Web deejay. HousingMaps.com injects housing listings from Craigslist into Google Maps, so people can visualize a rental's location.

Pretty soon, you won't need to be a programmer to tailor the Web precisely as you like it. Already, Web browser software lets you add functions, such as a Google toolbar, an ad blocker, or a weather forecasting button, to your screen. And an intriguing new program called Greasemonkey lets you add mini-programs that customize the way a particular Web site looks and works on your browser. Install the Greasemonkey add-on Book Burro, for instance, and every time you visit a book page on Amazon.com, a list of prices for that book on other sites pops up. Says Siva Kumar, president of the shopping search engine FatLens: "Where one site starts and another ends will increasingly be seamless."

The dizzying array of new choices certainly has the potential to overwhelm casual Web surfers and time-strapped workers alike. "The average user is too busy" to mess around a lot, says Jakob Nielsen, a Web design expert with consultant Nielsen Norman Group. "They just want to get work done." Yet that's precisely the reason many of the new Web applications have taken off. "It's all about doing things," says Jason Fried, president of 37Signals, creator of Basecamp and Backpack, two wildly popular Web services that help small businesses and individuals manage projects and to-do lists. "Cool wears off. Usefulness never does." ■

–By Robert D. Hof in San Mateo, Calif.

HOME

For complete online survey results go to BusinessWeek.com/extras

	BLOGS	SERVICES	PHOTOS
UR PICKS	**POSTSECRET** A site for people to display digital postcards revealing their secrets. Riveting.	**CRAIGSLIST** Rent an apartment, find a local runners' group, discover a date for this weekend. This is the place to do it.	**FOTOLOG.NET:** A global photo journal of what's happening today.

UR ONLINE EADERS' AVORITES	MAKE: BLOG*	BOING BOING.NET	POST SECRET	CRAIGS LIST.ORG	FREE CYCLE.ORG	BACK PACKIT	WEB SHOTS	FLICKR	SHUTTER FLY
	42%	26%	20%	59%	28%	9%	67%	27%	3%

*makezine.com/blog.com

it grows richer every day as 1.2 million users all over the world upload their photos—37 million of them, and counting.

For browsing, Fotolog.net, with 57 million photos, boasts a collection more geared to people-watching than Flickr's. One key difference is that most members are limited to uploading only one photo a day. So instead of putting an entire archive online, members are more likely to pick photos that illustrate th day. The result? Visitors can click through photo journals hundreds of thousands of lives all over the world. Of course Fotolog, as at most of these new interactive Web sites, parti pating is a lot more rewarding than just watching. ■

–By Stephen Baker in New Y

E-SOCIETY
MY WORLD IS CYWORLD

FOR LEE YU JIN, AN 18-YEAR-OLD FRESHman at Osan College in South Korea, Cyworld isn't just another Web site. It's the nexus of pretty much everything she does. The graphic design student posts all of her artwork and school papers on the site. She puts up photos of her friends, her family, and her parties. She keeps a daily blog there and chats with her boyfriend via the site's instant-messaging service. She even meets new friends, when their avatars, or digital stand-ins, stop by her Cyworld site. "I simply can't do without it," says Lee. "If someone is to block Cyworld today, I'll probably have to sue the person."

IMMATERIAL GIRL The unreal estate of Cyworld is Lee Yu Jin's true home

Cyworld is threatening to swallow South Korea. Less than four years after its launch, 15 million people, or almost a third of the country's population, are members. Among those in their late teens and early twenties, 90% are hooked. It's a Web phenomenon particular to Korea but indicative of a more general blurring between the digital and physical realms.

What is Cyworld, exactly? It's an Internet service that lets people create their own home pages—pages that can accommodate an unlimited numbers of photos, documents, and other goodies. It's similar to U.S. social networking sites such as MySpace or The Facebook, but with extra twists that mak more realistic and alluring. Home pages, for example, app three-dimensional. Users decorate their "rooms" with digi furniture, art, TVs, even music. Since avatars stop by, the idea to make your space as cool as possible. Instant messaging is cluded in the service, so you can chat with visitors. You can ev enter Cyworld from a mobile phone.

Cyworld took off after it was acquired in 2003 by SK Telec Co., Korea's largest wireless service provider. The idea, course, was to generate revenues. Although the service itsel free, when people add digital couches or TVs to their ho pages, they spend real money. They sw cash for a digital currency called *dotori* (K rean for "acorns"), which cost 10¢ each. instance, a digital couch costs six dotori. Communications, the subsidiary that ru Cyworld, chalked up a profit of $12.5 milli on sales of $110.4 million, nearly half by s ing *dotori*. The company expects sales double this year.

One feature that has helped Cyworld ta off is "wave riding." It works like this: Wh you're reading posts on bulletin boards looking at photo files, you can click on t name of someone who has added a remark photo you find interesting and you'll be tra ported to that person's digital room. If y like the art or music, you can introduce yo self and put in a request to become a "cybu dy." If accepted, you can use your buddy's goodies—from to photos—on your own page. The chain of wave-riding vis creates communities on the Net, which often develop i clubs of common interest in the real world: clubs for fishi bike riding, and going to jazz performances, among other

Letting users post as many photos as they want is anoth big draw. The growing popularity of digital cameras and ca era phones means youngsters increasingly use digital imag to share experiences or express themselves. An average of 6 million photos are uploaded to Cyworld each day, many

PLAY

For complete online survey results go t BusinessWeek.com/extra

	MUSIC	GAMES	HUMOR
OUR PICKS	**PANDORA** Plug in the name of your favorite bands and get radio customized for you.	**CYWORLD** This virtual village has taken Korea by storm. Almost a third of the country participates.	**JIBJAB** Politically correct it's not. What it is: laugh-out-loud, e-mail-to-your-friends funny.

OUR ONLINE READERS' FAVORITES	YAHOO! MUSIC*	iTUNES	RHAPSODY	WORLD OF WARCRAFT	FLEA FLICKER	EVER QUEST	DEFECTIVE YETI	THE ONION	THE PHAT PHREE
	50%	39%	3%	40%	14%	12%	48%	26%	15%

* launch.yahoo.com

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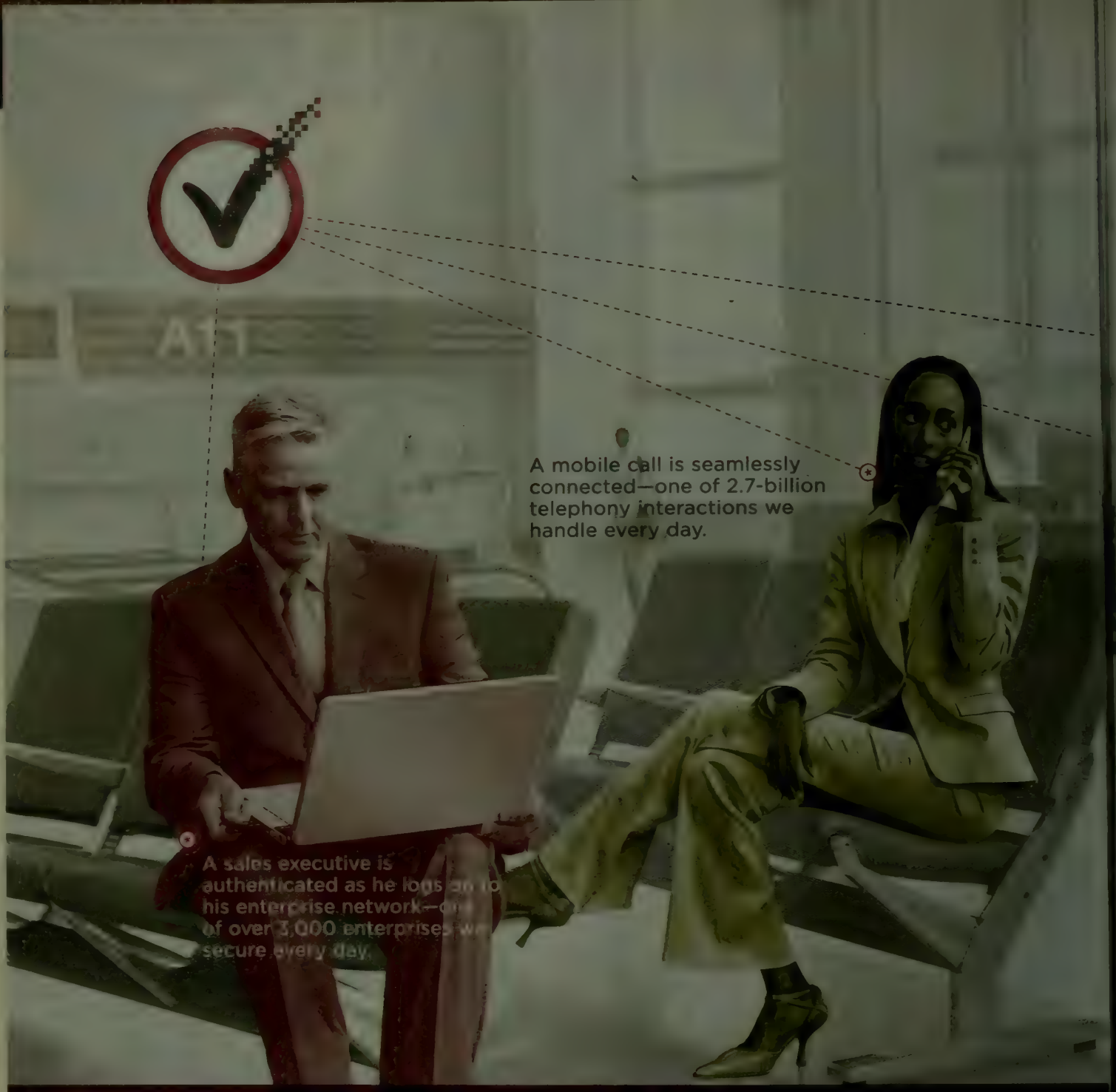

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them directly from cell phones. "I use Cyworld as the photo archive for my family," says Kim Joon, a 31-year-old software engineer who met his wife through a Cyworld club for virtual "families" in which he first played her husband. "My 1-year-old son will have a photo log of his life in Cyworld 20 years later."

That's exactly what SK intends. The more personal information people store on the service, the stronger their loyalty. The company stores users' birthdays and then reminds their cybuddies when the date is approaching. You can send a virtual card or music, for anywhere from 50¢ to $9. "Our goal is making users' online activities entwined with their offline life," says Shin Byung Hwi, senior manager at SK Communications.

DIGITAL DIGS Cyworld members spend real money to furnish their home pages

The service's popularity has me opportunity for some members. K Hyoung Gon, 25, won Cyworld fa by posting recipes with photograp of dishes on his home page—and th won a deal to write a cookbook. Ka Hee Jae, 31, quit her job and oper her own online shopping site after collection of dolls and clothes showed on her page drew 2.7 million visitors.

So is Cyworld a sign of things to come in other countri Companies such as MySpace, which was recently bought Rupert Murdoch's News Corp., are busily trying to create si ilar virtual societies in the U. S. and elsewhere. And SK execs hoping to repeat their success in other parts of the world. Th plan to launch customized versions in Japan, China, Taiw and the U.S. by yearend. Is your avatar ready? ■

–By Moon Ihlwan in Se

TAGGING
KEEPING TABS ON THE NET

MARK GHUNEIM, THE FOUNDER AND CHIEF EXECUTIVE OF New York City-based Wiredset Digital Agency, started using the Web site del.icio.us a year ago. He took advantage of its free technology to slap "tags," or labels, on interesting online articles or Web sites. That made it a breeze to go back and find everything he had tagged under "mashup" or "Live8."

Then it dawned on him. Del.icio.us could be extremely useful for his business. Wiredset helps entertainment companies develop their digital strategies. By following the tags for a band, Ghuneim could let a record company know the level of buzz after a radio interview or live performance. He could find chatter about budding artists. Essentially, del.icio.us would allow him to listen in on the conversations on the Net that he cared about, minute by minute. He's now obsessed. "There are amazingly few tools I care about on the Web, and this is one of them," Ghuneim says.

The power of del.icio.us stems from the clicking keyboards of

BLOC PARTY The band's buzz-factor is being monitored with del.icio.us Net tags

its many members. The service wa homegrown project created in 2003 by Joshua Schachter, an anal at Morgan Stanley, to track and sh bookmarks. As the system took Schachter quit his job and raised venture funding. N 200,000 subscribers busily label online articles, blog postin and more. They use tags like "katrina," often adding comme such as "Pictures of before and after. Very good." The proc creates a mountain of information subscribers can explore.

Now, companies are figuring out ways to take advantage

WORK

For complete online survey results go BusinessWeek.com/extr

	RESEARCH	COLLABORATION	TECH NEWS
OUR PICKS	**DEL.ICIO.US** Its tagging technology lets you track what's going on anyplace on the Web.	**BASECAMP** The latest way to manage collaborative projects, from marketing initiatives to weddings.	**DIGG.COM** Part news site, part blog, part forum, Digg.com users suggest stories. Voting shifts their prominence

OUR ONLINE READERS' FAVORITES	WIKIPEDIA .ORG	ANSWERS	DEL.ICIO.US	BASE CAMPHQ	SOURCE FORGE.NET	DIGG	OM MALIK'S BLOG*	SLASHDO .ORG
	48%	61%	7%	54%	20%	13%	70%	11%	10%

*gigaom.com

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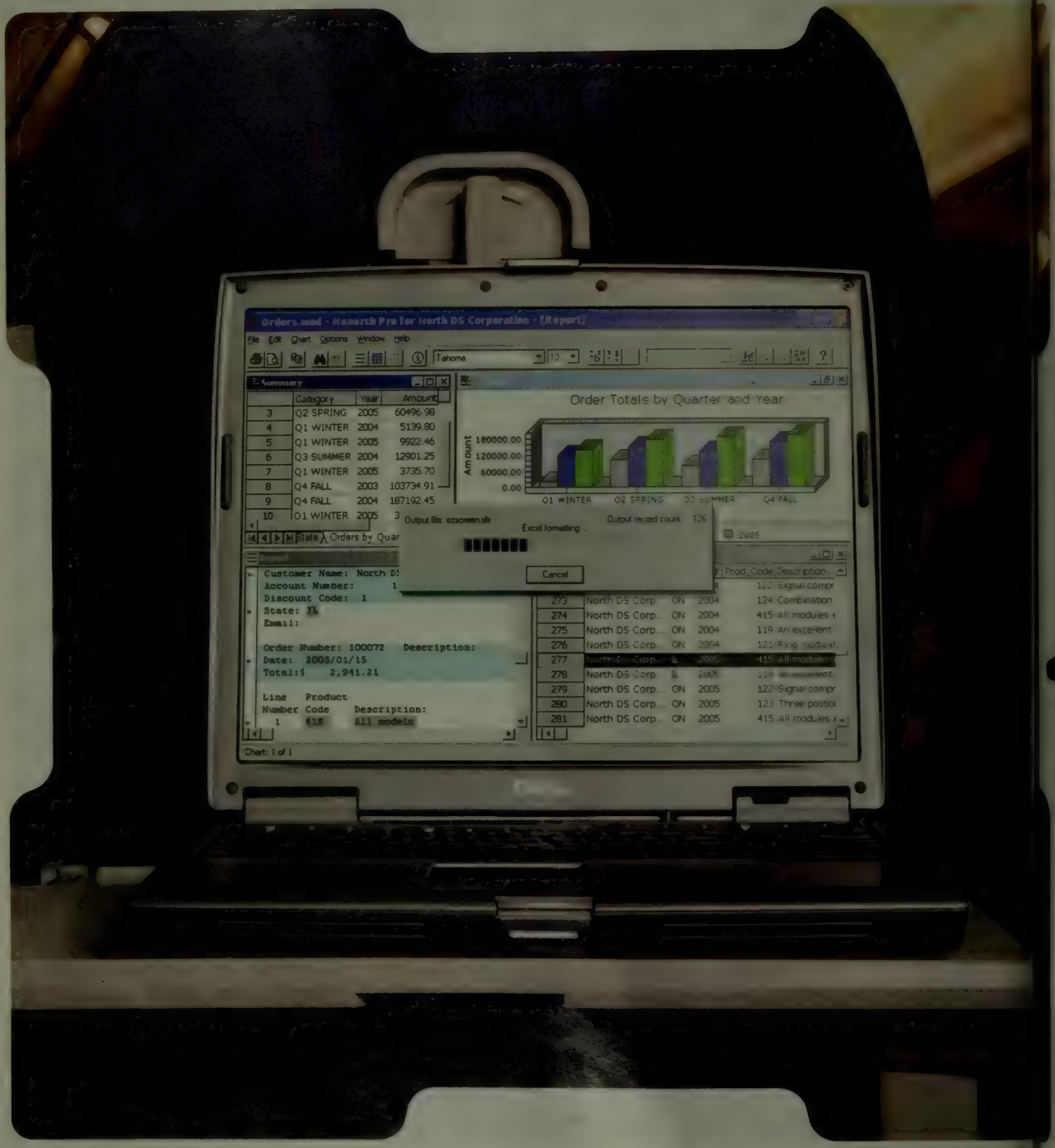

*Actual battery life will vary based on configuration, usage and manufacturing variability. Latitude D610 dual battery [illegible] based on the MobileMark 2002 Battery Life benchmark [illegible] performed by Dell Labs in February and March 2005 on a [illegible] with Intel Pentium M Processor 730 (1.60GHz), 14.1" [illegible] system memory, 40GB HDD, Windows XP Professional [illegible] Intel GMA 900 graphics, and dual [illegible] Dell 53WHr primary plus [illegible] secondary) batteries.

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MOBILE TECHNOLOGY

this phenomenon. As they tag, subscribers end up collectively highlighting changing trends and raging discussions all available at the del.icio.us site. Increasingly, innovative advertisers and other companies are trying to make sense of these discussions. "The conversation we're having with clients is, 'How do you stay on top of tagging? Because you need to, and it can be hugely beneficial,'" says Dan Buczaczer, a vice-president at ad firm Starcom Media Vest Group.

Wiredset is on the leading edge. It's developing a service for record labels that pulls together a variety of online data—sales on Amazon.com Inc., number of blog posts, tags on del.icio.us. The idea? Allow labels to see, in real time, the impact of their marketing. If Sony BMG Music Entertainment releases an MP3 from the band Franz Ferdinand on MySpace, it can track the buzz. Or watch how an MTV video affects Amazon sales. A test, Wiredset is tracking the tags of a London band, Bloc P ty. Wiredset follows the chatter around the band's new album pinpoint influential online players. "It's good to find and esta lish relationships we might not know about," says Adam Sho a general manager at Vice Records, Bloc Party's label.

Del.icio.us is getting put to work in other ways. When m keting agency MarCom:Interactive holds seminars, it now c ates resource pages with tags to blogs, Web sites, and resea presented in the seminar. Afterwards, MarCom and its clie can add more links, keeping the discussion going. Corporatio are just discovering tagging. But with its growing popular the mountain of tags to explore keeps rising ever higher. ■

–By Heather Green in New Y

SCHOOL AID
IT TAKES A WEB SITE

IN CHICAGO, A HIGH SCHOOL SOCIAL studies teacher needs 10 globes for hands-on geography lessons. Cost: $1,134. In Winston-Salem, N.C., a first-grade teacher wants the technology to let her young readers listen to books on tape. Cost: $667. And in Flushing, N.Y., a fifth-grade teacher at Public School 165 is trying to scare up five beanbag chairs for her library. Cost: $189.

Thanks to a charity called DonorsChoose.org, these teachers' wishes are coming true. In a move that redefines traditional philanthropy, DonorsChoose uses the Internet to connect teachers directly to donors. Teachers who once spent their own money for supplies, or simply went without, can now turn to donor support to roll out creative lesson plans. Meanwhile, rather than writing checks blindly, donors of any scale can decide which projects they wish to support. Like eBay or Amazon.com, DonorsChoose eliminates the middlem

BROOKLYN DonorsChoose paid for many books at P.S. 24

DonorsChoose has become something of a template for ch itable giving in education. It was founded in 2000 and focus solely on New York City until last year. Then, with additional nancial backing, it began a rapid expansion to Chicago, S Francisco, Los Angeles, and several cities in North and Sou Carolina. As far away as Hong Kong, entrepreneurs have veloped a Chinese version, at edexchange.com, to connect C nese teachers with donors. All told, DonorsChoose has funne nearly $4 million to more than 8,000 projects. Nearly 70% requests are funded within two months.

DonorsChoose is the brainchild of a f mer public high school teacher, Char Best. A soft-spoken Yale University grad ate with a shock of brown hair, the 29-ye old thought up the idea during his first y as a teacher at Wings Academy in Bro N.Y. He and his colleagues often around the staff lounge dreaming up pr ects they couldn't afford. Best figured th were probably plenty of people who wou rather fork over a bit of cash for a spec classroom project than write a check t traditional charity. So he moved back to his parents' home save money and designed the Web site. He persuaded c leagues to post the first requests, then used his savings to fu them anonymously.

The Web site reads like a "Dear Santa" list from teachers. I ucators submit a few paragraphs describing their ideas by w of request. Projects range from as little as $49 (clipboards) several thousand dollars (laptop computers). Volunteers vet

PUBLIC DOMAIN

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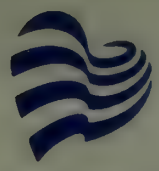

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nner Health is one of the largest not-for-profit healthcare systems in the U.S., with over 25,000 employees across multiple hospitals, ng-term care centers, and clinics. As a satisfied customer of Kronos' time & attendance solution, Banner is now reaping even greater iciencies by implementing Kronos' powerful scheduling solution. It's another way Kronos is helping Banner deliver superior care, hile controlling costs. To learn more, call (800) 225-1561 or visit www.kronos.com/healthcare.

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requests and post them for donors to browse. Once donors select a project, DonorsChoose staffers purchase and deliver the materials. One hundred percent of the money goes to the classrooms; DonorsChoose's 17 staffers are paid through grants and corporate sponsorships.

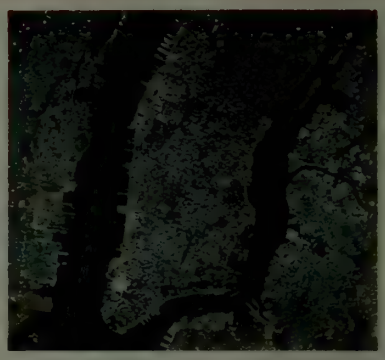
The results are powerful. The first year that Tracy Corsano taught fifth grade at P.S. 24 in Brooklyn, she spent $1,500 of her $32,000 salary on basic supplies for her students, more than 90% of whom qualified for free lunch. After hearing about DonorsChoose two years ago, she tried it out by posting a request for $396 to buy four sets of Scholastic's 100-volume library set. Within weeks, her bookshelves were full. Now, Corsano turns to DonorsChoose for many of her classroom needs. Last May she requested $300 for earth science books. That proposal has just been fulfilled, and this fall her students will research projects about the planet's crust, rivers, and lakes. Corsano: "If it weren't for DonorsChoose.org, I wouldn't most of my library."

Donors like the charity because they can target their fu and see their gifts at work. After Durham (N.C.) inve Michael Brader-Araje first heard about DonorsChoose, he nated $814 to fund a map and related teaching materials Bronx classroom. Two months later, Brader-Araje received tographs and thank-you letters from the students, writte scratchy pencil. "I was hooked," says Brader-Araje.

That kind of enthusiasm means that students this fall wi mapping out trips on newly purchased globes, learning words from books on tape, and lounging in beanbag chairs, r ing. For DonorsChoose, that is the true measure of success.

–By Jessi Hempel in New

AJAX HOW TO WEAVE A FASTER WEB



DO A SEARCH ON GOOGLE MAPS FOR YOUR HOUSE, AND YOU'LL see a nice enough map of your neighborhood. Now hold down the mouse button. You'll find you can move the map around as quickly as if it were sitting on a table. Zooming in and out, there's no delay waiting for the page to reload. And you can switch instantly to corresponding satellite photos and even a combined map-photo view.

Who would have thought poring over a map could be so fun? Credit a loose-knit set of programming technologies known as Ajax. It's helping to spur the explosion of Web sites, from Yahoo! Inc.'s photo-sharing service Flickr to Google Inc.'s Web-based e-mail service, that help you take a more active part in creating your own personal Web.

Essentially, Ajax speeds up the Web experience, vastly reducing the notorious World Wide Wait. A Web site created using Ajax updates pages behind the scenes, sending ancillary data you're likely to want next—such as filling in map data surrounding the current view. No more clicking the mouse and waiting for the page refresh. Says Jesse Ja Garrett, director of user perience at Web design sultant Adaptive Path, coined the term A "Companies are really st ing to recognize that Web is more than a med of static pages."

The upshot: For the time, the Web has becor place for real applications that match—and sometimes t scend—the performance of desktop software. "Until Google this technology out there, no one was really thinking of pages as applications," says Sapient Corp. software arch Francis Shanahan. "In the next 12 months, people will be th ing about the Web in a new way."

Ajax has rough edges. The programming tools behind it still primitive, so writing software with it takes longer. sometimes the resulting software flouts Web browser toms—for instance, disabling the "back" button. But alre Ajax is finding its way into mainstream business applicat such as Sabre Holdings Corp.'s air scheduling software.

Future possibilities are intriguing, too. Even with Amaz patented "one-click" buying, you have to click on mult pages to view a book, read reviews, get to the checkout page shopping cart. Garrett suggests Ajax might allow all that t done on one page. It doesn't get any speedier than that. ■

–By Robert D. Hof in San Mateo, C

TOOLBOX

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More power to you

Life Without AmEx

Ameriprise, the financial-planning unit AmEx is cutting loose faces a crowded field in targeting–you guessed it–baby boome

WHEN AMERICAN Express Co. gave James M. Cracchiolo the job of running its financial-planning group back in 2000, he thought he was getting the company's crown jewel. But almost immediately the business lost its luster. Bad investments from the late 1990s imploded, his mutual funds sank faster than the stock market, and regulators started making all sorts of serious charges. Mutual-fund assets plummeted, from $95 billion in 2000 to around $55 billion today, according to Boston's Financial Research Corp. "There were some cracks in the foundation," he says. After battling for five years to repair the damage, Cracchiolo was making progress. His reward: Chief Executive Kenneth I. Chenault called him into his New York City office last January and told the 23-year AmEx veteran his unit was being dumped. "It was shocking," recalls Cracchiolo.

Now he's on his own—as chief executive of Ameriprise Financial Inc., the new name for the American Express Financial Advisors unit AmEx will spin off on Sept. 30. The move will unload several laggard businesses from AmEx. And with that drag lifted, AmEx' shares should sell for more than 20 times earnings, up from 16 today, says T. Rowe Price Group Inc. stock analyst Kyle Cerminara. But now that Cracchiolo no longer has highly profitable AmEx activities such as credit cards to act as a safety net, pressure on him to perform will intensify.

The hurdles are many. Ameriprise inherits a perception that it caters largely to middle-class families, rather than upmarket clients. Cracchiolo plans to target affluent baby boomers who are nearing retirement, but that's a market where lots of rivals have a head start. He'll push new products and services to set Ameriprise apart in the marketp though the spin-off will have no mono on innovation. He'll also try to sell his tual funds through banks and other fi success there, however, depends on k ing the funds' improving perform from dropping again.

One edge: Adviser turnover is below the industry average

While AmEx may not think its finan planning business is valuable, Cracch hopes to persuade investors—who wi ceive one Ameriprise share for every AmEx shares they own—to see things ferently and stick with him. The new c pany will have 2.7 mi clients; 10,700 mostly i pendent advisers, the fou largest such force in the dustry; and more than 3 offices, third behind chovia and Edward Jone will also be one of the fe nancial-services firms o ing a complete range products, from life insur to mutual funds.

The business was a fi

CRACCHIOLO Settling allegations and restoring the firm's reputation has been a priority

cial-planning pioneer under the name IDS Financial Services before AmEx acquired it in 1984, and Cracchiolo hopes to return it to a preeminent role in the industry. Still, with $410 billion in client assets, it pales alongside the likes of Fidelity Investments ($2.2 trillion) and Merrill Lynch ($1.6 trillion).

Splitting his time between headquarters in downtown Minneapolis headquarters and a New York outpost, Brooklyn native Cracchiolo has focused on restoring the firm's reputation. In the past two years, it paid a total of $24.1 million to settle allegations that it overcharged mutual-fund clients and fraudulently steered customers to its in-house, underperforming products. In June it settled with New Jersey for $5 million for allegedly failing to properly supervise its advisers. In all four cases the firm neither denied nor admitted guilt.

One of Cracchiolo's first changes back in 2000 was to let his financial advisers recommend thousands of additional outside mutual funds rather than mainly its own products. v he has removed the extra compen- on that salespeople were getting for ng the firm's own funds. Also, he has costs by $900 million and slashed the kforce by 21%. Last year the unit ed $794 million on $7.2 billion in nue. Cracchiolo's goal is to raise earn- by 10% to 13% a year.

o get there, Cracchiolo is setting his ts on folks with $100,000 to $1 mil- to invest, the "mass affluent" in in- ry jargon. It's a highly profitable e, with 29 million households own- more than $8 trillion in investable as- , says Boston Consulting Group. It's dominated by boomers, who are in- singly turning to advisers to tackle r complicated finances as they head ard retirement. "We think this group nderserved by the competition, and hink we have the ability to serve them ," says Cracchiolo.

nfortunately, his rivals think they do, These days everyone from banks to e upstarts is targeting baby ners. Fidelity just signed former Beatle Paul McCartney to pitch its services. "It's the equivalent of saying a fast-food restaurant is going after teenage boys," says Gary Singer, chief strategy officer for consulting group Interbrand.

The key for Ameriprise, says Cracchiolo, will be to stand out from the herd. So he's relying on his army of advisers. Many have long-standing relationships with their clients—adviser turnover is below the industry average. Plus, Ameriprise counts more certified financial planners in its ranks than any of its rivals. So after the spin-off, it will devote a major portion of its $300 million in marketing to promoting its advisers, including funding both local advertising campaigns for them and local events to attract clients. "These firms are essentially selling the same products, so the relationship between the adviser and the client is important," says Denise Valentine, a senior analyst at Celent Communications. "When you look at the Ameriprise reps, you're seeing advisers with a lot of tenure."

Cracchiolo wants to give those advisers something distinctive to sell. New Gold and Platinum programs launched over the past few years offer traditional services such as wealth management, tax strategies, and retirement planning. Depending on which service customers pick, they also get a dedicated customer-service line, discounted home loans, estate-planning services, and access to hedge funds. Clients need $100,000 in assets to qualify for the Gold program and $500,000 for Platinum.

Such bells and whistles, however, are no substitute for higher mutual-fund returns. At the end of 2002, only 12% of Ameriprise's equity funds had beaten the average of their peer groups over the previous three years, according to Lipper Inc. To boost that performance, Cracchiolo hired a team from Fidelity in 2002 to run some of the domestic equity portfolios and acquired Britain-based Threadneedle Asset Management in 2003 to build a deep bench in global equities. Now more than half the firm's stock funds beat the average.

Growth Plan

After the spin-off on Sept. 30, Ameriprise, the former American Express Financial Advisors, hopes to:

DISTINGUISH ITSELF IN THE MARKETPLACE
It's offering new programs, such as all-in-one services, from tuition financing to estate planning, and new products, such as return guarantees on annuities

EXPAND ITS REACH
Maintain the improved performance of its mutual funds so that banks and brokers, not just Ameriprise's own army of 10,700 financial planners, will want to market them

WIN OVER BOOMERS
Woo affluent baby boomers now nearing retirement, while overcoming the firm's image of catering largely to middle-class families

NEW PRODUCTS

INVESTORS DON'T SEEM impressed. In the year through July 31, they pulled some $6 billion out of Ameriprise funds, says FRC. In part, says Cracchiolo, those losses have been amplified as his advisers shift away from selling mainly in-house funds because they have many more choices now. As his funds' long-term record improves, he hopes to win over both his advisers and outside vendors so that they will want to sell his funds, as they do his annuity products. "Improving the performance of the funds is the quickest way to alleviate that problem of not having a captive audience," says Morningstar Inc. analyst Arijit Dutta. "If it's a good fund, any adviser can recommend it."

He also hopes to make his products more appealing via other innovations. Ameriprise recently introduced a guaranteed-returns feature for its annuities, which not only promises investors a certain level of income but also allows them to capture a portion of gains made by investments underlying the annuities. And it plans more mutual funds like its Managed Allocation Fund, which varies stock and bond holdings based on valuations and earnings.

All this is familiar territory for Cracchiolo, who was instrumental in turning around Shearson Lehman before AmEx sold the brokerage firm to Primerica in 1993. So he knows he's far from done. "It takes a while to change a reputation," he says. But now, as CEO of a public company, he has to wonder whether the market will give him that time—and how long he'll be able to stay independent. ■

–By Adrienne Carter in Minneapolis, with Mara Der Hovanesian in New York

The SEC: Cracking Down on Spin

It's going after executives for skimpy or misleading disclosures in annual reports

THE SECURITIES & EXchange Commission threw the book at two former top executives of Kmart Corp. on Aug. 23. The agency requested unspecified penalties and a bar on the pair ever again serving as officers or directors of a public company. The executives—former CEO Charles C. Conaway and former CFO John T. McDonald Jr.—weren't accused of fudging Kmart's numbers. What incurred the SEC's wrath was their allegedly misleading explanation of the Troy (Mich.) retailer's finances in its 2001 quarterly reports. Lawyers for Conaway and McDonald say their clients contest the allegations and expect to be exonerated.

The civil suit is the latest sign that the SEC intends to turn the "management's discussion and analysis" (MD&A) section of quarterly and annual reports into a no-spin zone. Already, hundreds of companies have received letters exhorting them to tell the unvarnished truth. The reports are supposed to discuss the story behind the numbers, highlighting factors that could have a significant impact on company financials. But the SEC believes too many managers may be ing investors a skimpy or distorted ture of their business.

In Kmart's case, executives blamed a spike in inventories on "seasonal fluc tions." In fact, the SEC alleges, they w hiding massive unauthorized purchase one top official. The SEC also alleged the executives lied about why Kmart slowing payments to vendors and the pact the company's liquidity crisis hac its relations with vendors. Kmart filed bankruptcy in 2002. After reorganizin acquired Sears, Roebuck & Co., now S Holdings Corp., in March.

BUSY PIPELINE

MISLEADING MD&A reports also wer the heart of cases the SEC brough April against Coca-Cola Co. and Gl Crossing Ltd. Without admit or denying wrongdoing, C settled charges that it faile disclose shipments of ex beverage concentrate to bottle Japan from 1997 through 1999 to n earnings expectations. Such "gal pushing" isn't illegal, but the SEC Coke left investors in the dark about impact on company finances. The faulted Global Crossing and three for executives for inadequate disclosur fiber-optic capacity swaps with other com carriers in 2001. Global Crossing the executives—who each paid pena of $100,000—settled the charges wit admitting or denying guilt.

Defense lawyers and compliance perts suspect more such cases are in pipeline. Now that most companies h adjusted to the major reporting requ ments in the Sarbanes-Oxley Act, ther renewed focus on risk assessment and closure, says Scott S. Cohen, editor publisher of newsletter *Compliance W* "Everyone, from regulators to institut al investors, has been calling on compa to provide more clear, forward-look transparent, 'plain E lish' MD&A," Cohen sa

CEOs, who must s the reports, can't bl shoddy MD&A dis sions on auditors or o gatekeepers. The MI "is specifically designe let investors view company's financial c dition through the eye management," says P H. Bresnan, an assoc director at the SEC's forcement Div.

Managers had an

Distortion-Free Zone

The SEC is pushing companies to make the management discussion and analysis sections of annual reports more straightforward, complete, and understandable. Companies must:

- [illegible] investors the good, the bad, and the ugly about what's happening in their business—in plain English
- [illegible] on key trends and events and their impact on company liquidity, capital, revenues, and profits
- [illegible] what the financial numbers really mean, not simply list them mechanically

Data: BusinessWeek

It's time for street corner offices.

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warning about what the SEC expects. Agency staffers have issued repeated guidance on what MD&A should cover. "What we are looking for in MD&A is the fresh story," says SEC chief accountant Donald T. Nicolaisen. "Often management repeats the same old boilerplate again and again. There is high resistance to change."

BEEFED-UP REPORTS

DATABASES OF SEC documents compiled by Global Securities Information Inc., a publisher of the SEC's electronic document filing service, reveal a constant stream of staff requests to companies to amend and expand their MD&A filings. On Aug. 9, Johnson Controls Inc. added 14 pages of information to its 2004 annual report in response to SEC requests. "We've gotten mixed messages from investors about it, though some say 'the more information, the better,'" says R. Bruce McDonald, Johnson Controls' CFO. In March, Dress Barn Inc. beefed up its management discussion for its 2004 annual report after the SEC asked for an overview that would "identify the most important matters on which you focus in evaluating financial condition and operating performance."

Still, corporate arrogance remains an obstacle to candid, easy-to-read reports.

Corporate arrogance remains an obstacle to candid, clear reports

"Many executives t they can get away spoon-feeding inve whatever inform they want them to not what they're ent to," says former SEC accountant Lynn E. T er, a managing direct investment resea Glass, Lewis & Co.

Corporate lawyer gue that managers valid reasons to parse their words. ing too much could give rivals an e saying too little could invite shareh suits. And there are tough calls. If a pany's biggest customer is threate

ACCOUNTING

Report From a General in The SEC's War on Fraud

For two years, as chief accountant at the Securities & Exchange Commission, Donald T. Nicolaisen has had a ringside seat at the games executives and auditors play with financial reports. He took the job in September, 2003, when the big accounting scandals were being laid bare. A former senior partner at PricewaterhouseCoopers LLP, he doubled his staff as he oversaw controversial new SEC rules. Nicolaisen, 61, plans to leave the agency in October. Recently he talked with Senior Writer David Henry and Correspondent Amy Borrus. Here are a few edited highlights:

What has surprised you most in the two years you've been chief accountant?

I had grown up in the accounting and auditing profession and was proud of it. But when I came here, I saw over and over again how investors and the general public had lost confidence [in the business community, including accountants and auditors]—it was dramatic. Also, I've been impressed by the sincerity, focus, and intellectual capacity that exists [at the SEC]. I've felt many times that I could accomplish important things with greater dispatch here than when I was in the private sector.

How reliable are financial reports today?

In each of the years I've been here, 7% to 10% of companies have had to restate earnings. That is unacceptable. Accounting has become rules-based and overly complex. Even sophisticated accountants have trouble transitioning from one industry to another. You see in restatements everything from deliberate misrepresentation to pure accidents. For example, the volume of restatements because of lease transactions was a surprise. For whatever reason, some companies and auditors concluded that they didn't need to follow all of the rules. You think you've all, and you never have.

NICOLAISEN Simplifying the rules is urgent

Has the monster wave of scandals its course?

I believe we're at the end of the ma frauds we saw with Enron and WorldC Problems remain, but they're not of t magnitude. Audit committees are as questions. Auditors are asking r questions, and analysts are ask questions. There's less inclinati believe something that seems t be true.

What accounting games do y for now?

I pay attention to companies wouldn't expect to outperform t by a wide margin for an extende of time. I won't name names, bu extremely difficult to consistent averages and produce outsize re also concerned about highly co structured transactions that lac economic substance. You still se every area of financial reporting including taxes. We've also hear very creative presentations fro and individual companies atten justify the accounting.

Is the culture of auditing firm better than it was?

Yes. It has changed dramatically. Nevertheless, having some public representatives, rather than only insi involved in the governance structure accounting firms would do a lot of go

Will the Big Four accounting firms become the Big Five or Six again?

To do it via growth is very hard. Th

walk, must management disclose t? Lawyers say it depends on ether management believes it will e the customer. "There are a lot of y areas," says Brian Lane, a partner Gibson, Dunn & Crutcher and a for- r director of the SEC's Corporation ance Div.

So far, the agency has been vigilant ut flushing out executives who try to e bad news in those gray areas. If the art case goes to trial, it will show just v much power the SEC has to deal shly with those it thinks have given estors a whitewashed version of npany finances. ■

–By Amy Borrus in Washington

other firms combined are still less e of KPMG, the smallest of the Big r is not as desirable as six but can ate.

smaller companies get relief from l to assess their internal financial ?

ternal-control requirements are arger companies and auditors dig nd produce better information. Small es need strong controls, too, but we fferent framework—one tailored to icular structure. Under the current rk the cost may be enormous. These es make up only 1% or 2% of market ation. I have always encouraged neurship and growth in the small- arena, so this must be resolved.

e been adamant that accounting ls are too complex, yet the latest es are dense. Are straightforward ls a dream?

think so. We can't continue to make reporting ever more complex. I would to see an international, high-level— residential-level—panel committed to ing these issues. At the moment we g past one another.

you want to do next?

to take on one more tough challenge an make a difference at a major entity ls somebody with my background, vel, and interest. I'm very interested in and meeting investor expectations. uld like to serve on a couple of boards. orked hard on corporate-governance d like to witness firsthand how they ng. I suspect I'll stay in the New York ere I spent the bulk of my career in services.

An Unbreached Financial Levee

Katrina wasn't powerful enough to trigger losses in catastrophe bonds

HURRICANE KATRINA was one of the worst natural disasters in U.S. history. Deadly as it was, though, investors in catastrophe bonds were sitting pretty. The bonds are issued by insurers to cover huge losses from bad weather or earthquakes. Investors are effectively acting just like insurers; if the worst happens, investors forfeit some or all of their capital. But Katrina wasn't powerful enough, or cause enough damage, for that to happen.

Why would anyone buy such risky bonds? For major pension funds and the like, their high yields—around 7% now—are a big attraction. What's more, the bonds may be less risky than they look. Since insurers started issuing them in 1992 after sustaining huge losses on Hurricane Andrew, they've never collected on any of the bonds. In Katrina's case, wind speeds weren't high enough or barometric pressure low enough at the eye to trigger some of the $2 billion in bonds issued to cover Atlantic storms. Insured losses along Katrina's path apparently aren't big enough to trigger others.

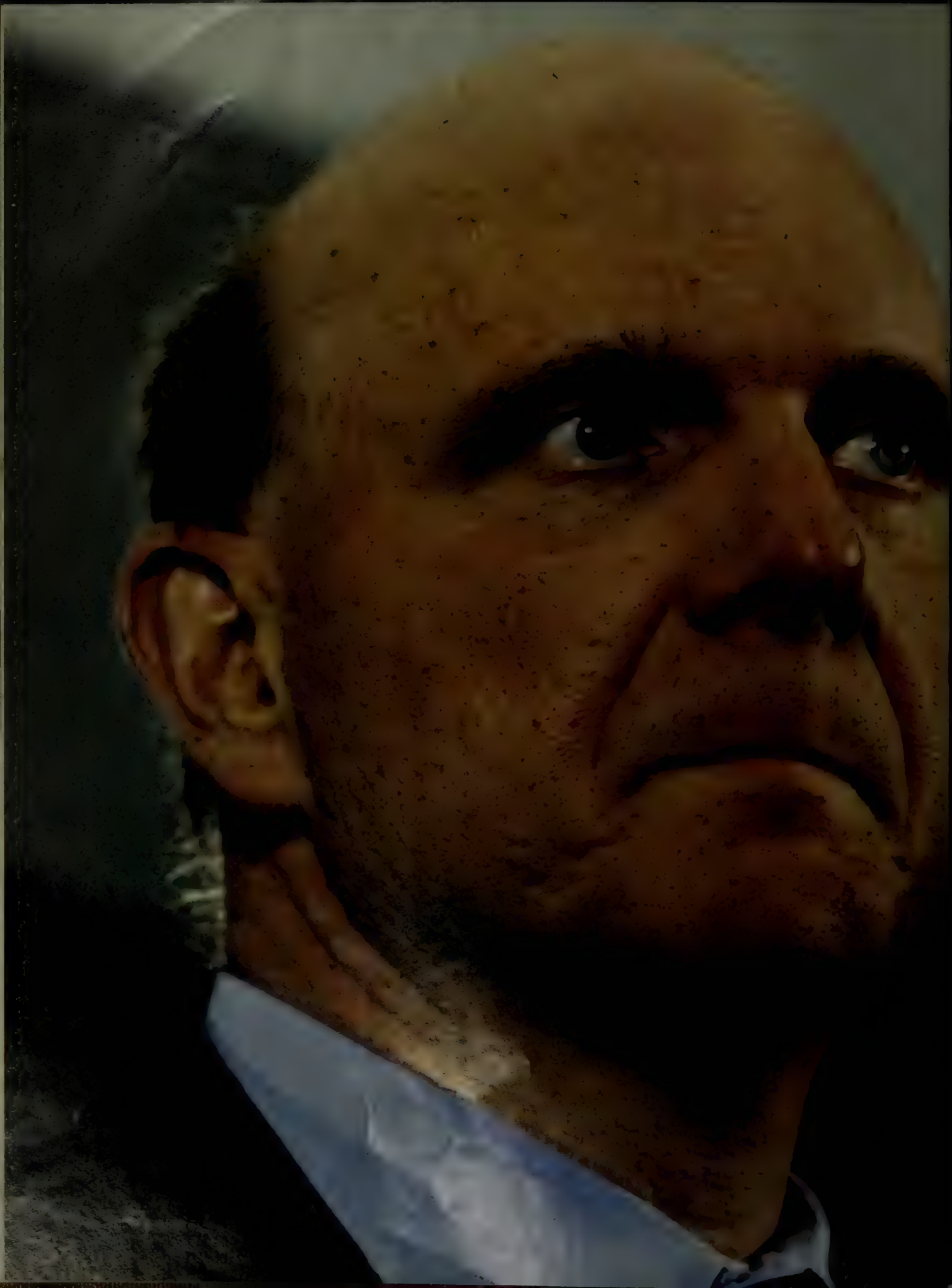
That's not to say catastrophe bonds won't ever be wiped out. Several famous past disasters would have done the trick. Swiss reinsurer Converium Holding, which issued $100 million in such bonds last year, ran 21 of the worst disasters through its computer model. Seven would have triggered the bonds, but only four would have caused serious losses for bondholders. The earthquake that leveled San Francisco in 1906 would have wiped out the entire $100 million, while the unnamed hurricane that killed 600 in New York and New England in 1938 would have taken $61 million. Converium's bonds also can be triggered by a serious earthquake in Japan or windstorm in Europe, but only if the disaster is the second during the bonds' five-year term.

Although the bonds are in high demand, insurers haven't been eager to issue them and share the premiums they get with investors. New issues totaled $1.14 billion last year, down from a record $1.73 billion in 2003, according to Marsh & McLennan Cos. affiliate MMC Securities Corp. Since Andrew and the Northridge (Calif.) earthquake in 1994, insurers and reinsurers have amassed more capital by boosting their reserves and increasing premiums. "We've been disappointed [that] the market hasn't grown as much as their chief sponsors said it would," says Keith Ashton, director of pension fund TIAA-CREF's asset-backed securities department. But after insurers finish stumping up their Katrina losses, now estimated at around $40 billion, they may start issuing more cat bonds. ■

—By Aaron Pressman in Boston and Chester Dawson in New York

NO FORFEIT Insured losses aren't big enough

ROBERT SULLIVAN/AFP/GETTY IMAGES



Troubling Exits At Microsoft

Once the dream workplace of tech's highest achievers, it is suffering key defections to Google and elsewhere. What's behind the losses?

BY JAY GREENE

WHEN MICROSOFT CORP. hired computer scientist Kai-Fu Lee away from hardware maker Silicon Graphics Inc. in 1998, the move underscored how thoroughly the software giant dominated the computer industry. Not only did it monopolize PC operating systems and hold an edge in Web browsers, but it was also vacuuming up the world's brightest technologists. Lee's expertise was in speech recognition, considered one of the next big leaps in computing. With people like him flocking to Microsoft's labs, it seemed that the digital world's reigning champion had a lock on the future.

Things didn't turn out that way. In July, Lee bolted from Microsoft for Web search king Google Inc., and once again his personal journey is emblematic of a shift in computing's balance of power. These days it's Google, not Microsoft,

BALLMER The CEO says Microsoft's healthy culture of self-criticism has simply spilled out because of blogs and e-mail

CHRIS KLEPONIS/ZUMA PRESS

that seems to have the most momentum. Microsoft sued to stop Lee from working for the upstart, citing his noncompete agreement. But on Sept. 13 a state judge in Seattle ruled that Lee could work for Google, with some restrictions, pending a January trial. Microsoft said it was happy the judge limited the type of work Lee could do. Yet when court adjourned, Lee smiled broadly and threw both arms in the air. "I feel great," he said outside the courtroom. "I can't wait to start work tomorrow morning."

Contrast that with how Lee felt about Microsoft. During the two-day hearing he painted a distinctly unflattering picture of the company's inner workings. Lee, who opened Microsoft's research lab in China in 1998 and moved to headquarters in Redmond, Wash., two years later, fretted over what he saw as repeated missteps. In court he detailed how the more than 20 product-development centers in China tripped over one another, duplicating efforts and even fighting over the same job candidate. Lee called the company "incompetent." After the ruling he praised Google, noting, "the culture is very supportive, collaborative, innovative, and Internet-like—and that's bottoms-up innovation rather than top-down direction."

For most of its three decades, Microsoft has faced intense criticism. But in the past it came from the outside world. Rivals complained about its heavy-handed tactics. PC makers griped that it was hogging the industry's profits.

Now much of the sharpest criticism comes from within. Dozens of current and former employees are criticizing—in *BusinessWeek* interviews, court testimony, and personal blogs—the way the company operates internally. This spring two researchers sent Chairman William H. Gates III a memo in which they wrote: "Everyone sees a crisis is imminent" and suggested "Ten Crazy Ideas to Shake Up Microsoft." Many workers, like Lee, are in effect saying: "I'm outta here." More than 100 former Microsofties now work for Google, and dozens of others have scattered elsewhere.

It's not a mass exodus. Microsoft has 60,000 employees, and many of them are undoubtedly happy with their jobs and the company's culture. While Microsoft's annual attrition rate rose one percentage point from fiscal 2003 to 2004, it's still just 9%, a bit lower than the industry average. Microsoft says it receives 45,000 to 60,000 job applications a month, and over 90% of the people offered jobs accept.

LEE He lauds Google's "supportive, collaborative, innovative, and Internet-like" culture

TOO BIG TO MOVE FAST?

STILL, THERE'S NO DOUBT THAT Microsoft is losing some of its most creative managers, marketers, and software developers. Lenn Pryor, director of platform evangelism, left for Internet phone startup Skype Technologies, now being acquired by eBay. Stephen Walli, who worked in the unit set up to parry the open-source threat, split for an open-source consulting firm. A long list of talent has moved to Google, a trip made easier by the company's recent establishment of an office in nearby Kirkland, Wash. Joe Beda and Gary Burd, respected engineers, left and helped set up the instant messaging service Google Talk. Mark Lucovsky, who had been named one of Microsoft's 16 Distinguished Engineers, defected to Google last November. He blogged that Microsoft's size is getting in its way. "I am not sure I believe anymore that Microsoft knows how to ship software," he w

Employees' complaints are rooted in a number of fac They resent cuts in compensation and benefits as profits They're disappointed with the stock price, which has b budged for three years, rendering many of their stock op out of the money. They're frustrated with what they se swelling bureaucracy, including the many procedures meetings Chief Executive Steven A. Ballmer has put in pla motivate them. And they're feeling trapped in an organiz whose past successes seem to stifle current creativity. "Th a distinct lack of passion," says one engineer, who would only on condition of anonymity. "We're missing some spu

No question, most companies would kill to have Micros problems. It's comfortably the most profitable player in the industry. And it's making more money than ever, with ne come of $12.3 billion on revenues of $39.8 billion for the fiscal year. Its twin monopolies, the Windows PC operating tem and the Office suite of desktop applications, give it im tant advantages when it thrusts into adjacent markets, suc server software for corporations and instant messaging for businesses and consumers.

Ballmer maintains that the company is in terrific shape. interview in a Las Vegas hotel, he says one of Micros strengths has always been its culture of self-criticism. W different now, he says, is that the internal debate is spillin into public view because of blogs and e-mail. He says inte surveys show that 85% of the company's employees are sati with their jobs, about the same level as in past years. "We as excited and engaged a team of folks at Microsoft as I can sibly imagine," says Ballmer. "[Employees] love their w They're passionate about the impact they're having on

> I'm deeply disappointed at our incompetence n China—that we have asted so many years in hina with so little to show."
>
> *–Speech-recognition expert Kai-Fu Lee (in a 2003 e-mail to Gates and Ballmer), who has now jumped ship to Google*

ers and society. [The 85% number] is a real, real powerful ement about where our people are."

ndeed, there are areas of excitement within Microsoft. One ISN, the Internet operation, where the search group is the erdog competing against Google. Another is the Xbox ıp, which is racing full speed against Sony Corp.'s leading Station 2 to win over the next generation of video gamers. launching Xbox 360 this Christmas, months ahead of Station 3. "If you take a look at where we're going with in- ation, what we have in the pipeline, I'm very excited. The ut of our innovation is great," says Ballmer. "We won the top. We won the server. We will win the Web. We will move , we will get there. We will win the Web."

he company plans to release a series of major upgrades for t of its core products in the coming 18 months. That'll cul- ate late next year in the long-awaited update of Windows, d Vista. Analysts such as Drew Brosseau of SG Cowen & Co. ct it to help financial results—he's predicting that revenues rise 12% during the next fiscal year, to $44.5 billion, as profits increase 12%, to $13.8 billion. He thinks the stock, now at $27, will follow. "It can be a mid-30s stock in 12 months," says Brosseau.

Still, Microsoft faces serious long-term challenges: the rising popularity of the Linux open-source operating system, a plague of viruses attacking its software, and potent rivals such as Google in the consumer realm and IBM in corporate computing. It's the company's ability to respond to these challenges that current and former employees fear is being compromised by Microsoft's internal troubles. They're concerned that Ballmer and Gates aren't taking seriously enough the issues of morale and culture. "Why in the world did I start [this blog]?" writes Mini-Microsoft, an anonymous employee who writes a blog that has become a gathering place for the company's internal critics and reformers (page 104). "I love Microsoft, and I know we have the innate potential to be great again."

To many employees, Vista, the Windows update, exemplifies the company's struggles. When the project was conceived half a decade ago, it was envisioned as a breakthrough: an operating system that would transform the way users store and retrieve information. But the more revolutionary features have been dropped, and Vista will arrive three years after researcher Gartner Inc. originally predicted that it would ship. Worse yet, they say, nobody has been held accountable. "People look around and say: 'What are those clowns doing?'" says Adam Barr, a program manager in the Windows group.

In the past, when Microsoft faced an emerging threat, Gates could be depended on to lead it in a new direction. Most famously, in 1995 he belatedly recognized the importance of the Internet and led a furious charge to catch up. But in 2000 Gates passed on the chief executive job to Ballmer. When Ballmer took over, he was determined to overcome the looming challenge of corporate middle age. He pored over how-to management books such as Jim Collins' *Good to Great*. But since Ballmer took the helm, Microsoft has slipped the other way. The stock price has dropped over 40% during his tenure, and the company, whose revenue grew at an average annual clip of 36% through the 1990s, rose just 8% in the fiscal year that ended on

What Ails Microsoft?

ne software giant faces plenty of competition, and now some of its biggest challenges ome from the inside. Here are the company's main internal problems:

INNOVATION STAGNATION

ndows and Office still y the bills, so Microsoft eds to keep improving em with new versions that crease security and make asier for them to work h other devices. But all e focus on existing oducts has left it behind ovators such as Google d Apple when it comes fresh ideas.

SLOW PRODUCT DEVELOPMENT

Microsoft's top execs have pushed a vision of "integrated innovation" meant to ensure that the company's many product groups work closely together. Sounds good, but in practice the strategy creates dependencies that saddle fast-moving groups with the problems of troubled divisions, slowing down innovation.

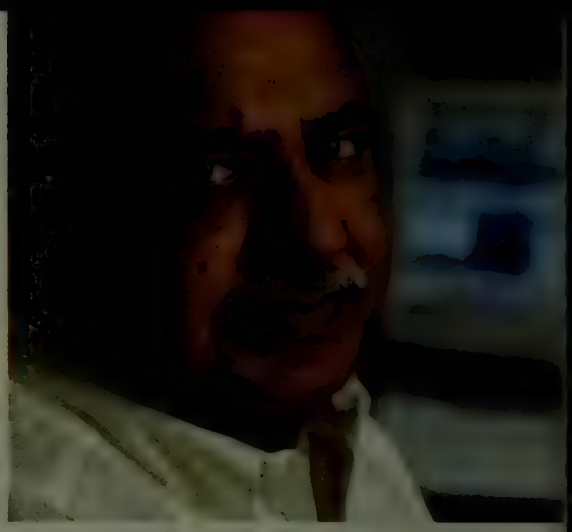
BUREAUCRATIC RED TAPE

Employees complain about an endless string of meetings to discuss everything from product features to coordinating strategies among different groups. It's part of the pain of being a large company. But the process put in place to help workers deal with that growth takes valuable time away from creating new products.

SAGGING MORALE

With the company's stock trading where it was seven years ago, Microsoft is no longer minting stock-option millionaires. What's more, it has cut health benefits and trimmed vacation time for new employees. Combine this with other internal woes, and you have some of the company's most talented employees heading elsewhere.

> "I think they should break up the company. They need to have nimble operations where 1,000 flowers can bloom."
>
> *–Raj Reddy, Carnegie Mellon University, who has served on Microsoft's Technical Advisory Board for 15 years*



June 30. That's good for a company of Microsoft's size, but it is the first time the software giant has had single-digit growth.

The company's performance even has some anonymous writers on the Mini-Microsoft Web site calling on Gates to ask Ballmer to step down. That's very, very unlikely. Gates urged Ballmer to become chief executive nearly six years ago in the wake of the company's antitrust battles with the Justice Dept., when the top job became too overwhelming for him. The two have been close friends since their days at Harvard University, and together they hold 12% of the company's shares. And board members say they stand firmly behind Ballmer. "I am fully s portive of the transformation that Steve is leading the comp through," James I. Cash Sr., a director and former professo Harvard Business School, wrote in an e-mail to *BusinessW* "He is one of the best leaders I've observed over the last years I've been on this Board, and the Board stands in full s port of him and his efforts."

Ballmer says he should be judged on his overall performa "At the end of the day the proof is in the output. If you loo any of the critical dimensions, our company has performed

Q&A

Steve Ballmer Shrugs Off the Critics

Steven A. Ballmer has been Microsoft Corp.'s chief executive officer for nearly five years. He has steered the company through the tech downturn and a slowdown in revenue growth. Now he's predicting an upswing. *BusinessWeek* Seattle Bureau Chief Jay Greene and Executive Editor Kathy Rebello interviewed Ballmer at the Venetian Hotel in Las Vegas. This is an edited version of their conversation:

How is morale at Microsoft?
We have as excited and engaged a team of folks as I can possibly imagine. Eighty-five percent of our people say they feel strongly that they're proud to be at Microsoft. They love their work. They're passionate about the impact they're having on customers and society. It's a real, real powerful statement about where our people are. Certainly, we continue to bring in new people. We will hire, in net, over 4,000 people this year. We attract great people to the company. I'm very bullish about the employee base and what it can accomplish.

Two researchers at Microsoft wrote a paper for [Bill Gates] called "Ten Crazy Ideas to Shake Up Microsoft." They say "a crisis is imminent" because of the growing bureaucracy and impediments to innovation. Do you agree?
I think we have a great culture at Microsoft. It's a culture that encourages and fosters criticism and constructive suggestion. People criticize everything: the way we do things, what we need to do in the market place, our product. That's a fantastic thing because that kind of strong culture drives self-improvement. We have the best new pipeline of innovation that we've ever had in our history over the next 12 months.

To be clear, do you think the points the authors made in that paper are valid ones that need to be addressed?
If you take a look at where we're going to with innovation, what we have in the pipeline, I'm very excited. I think the output of our innovation is great. We have a culture of self-improvement. I know we can continue to improve. But, at the same time, our absolute level of output is fantastic.

Do you have concerns about the bureaucracy at Microsoft?
Great companies and the way they work start with great leaders. We have a fantastic leadership team in place. Our leadership team is empowered, and is pushing every day to take advantage of that empowerment, to move quickly, to act quickly, to drive, to get things done.

Does process hold them back at all?
Our company has to be a company that enables its people. I think if you were to take a look broadly through our company, we've got more empowered, innovative, creative people than any other company in the world. I think we've been very good at investing in the tools that allow people to work together in a way in which the whole is bigger than the sum of the parts.

Some of this sentiment comes out in blogs like Mini-Microsoft and others. Do you read those?
I do not.

CAN KRAUSS/THE NEW YORK TIMES

d I'm bullish about how we will drive to continue." While Microsoft's internal reformers don't directly criticize ıtes, they're frustrated with the sluggish pace of product de-lopment. As the company's chief software architect, Gates ars that responsibility. He's the author of a strategy called "in-grated innovation." The idea is to get Microsoft's vast product oups to work closely together to take advantage of the Win-ws and Office monopolies and bolster them at the same time. ıt with so much more effort placed on cross-group collabora-n, workers spend an immense amount of time in meetings ıking sure products are in sync. It "translates to more de-ndencies among shipping products, less control of one's prod-t destiny, and longer ship cycles," writes Dare Obasanjo, a pro-am manager in Microsoft's MSN division, on his blog.

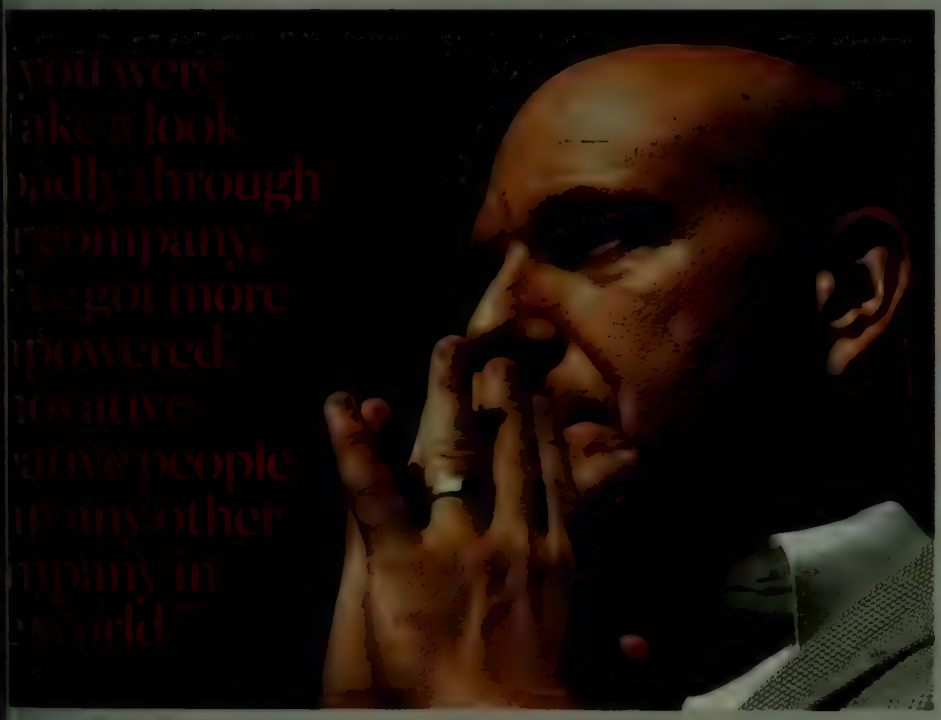
To shake Microsoft out of its malaise, radical surgery may be order. "I think they should break up the company," says Raj ddy, a professor of computer science and robotics at rnegie Mellon University. Reddy is no passive industry ob-ver: For the past 15 years he has served on Microsoft's Tech-al Advisory Board, a group of academics who help guide the mpany's research efforts. Reddy believes that a handful of crosoft spin-offs, seeded with some of the company's $37.8 lion in cash, could compete more nimbly in the marketplace. me insiders agree. Microsoft's Barr recently blogged that the mpany should be broken up after Gates and Ballmer retire.

There are plenty of bold thoughts floating around Microsoft. e two reseachers who sent the "Ten Crazy Ideas" memo to Gates are Kentaro Toyama and Sean Blagsvedt. The 12-page document, reviewed by *BusinessWeek*, suggests giving product groups increased autonomy and calls for the creation of "bureaucracy police" with the authority to slash through red tape. "It's said that large organizations won't change their ways until a crisis really hits," the authors write. "Everyone sees a crisis is imminent. Incremental changes aren't enough. Are we the kind of company that can dodge the crisis before it happens?"

MAINTAINING, NOT INNOVATING

IT'S A QUESTION THAT ECHOES through the corridors in Redmond. To succeed, Microsoft needs motivated workers camping out in their offices at all hours to compete with tenacious rivals such as Google, Yahoo!, Salesforce.com, and a reborn Apple Computer. Yet current and former employees say there are many demoralized workers who are content to punch the clock and zoom out of the parking lot. "At this point there's a traffic jam at 9 o'clock in the morning and 5 o'clock at night," says ex-employee Walli.

Over its three decades of life, Microsoft has become an icon of American capitalism, a company that started with the intellectual firepower and relentless drive of Gates and his high school buddy, Paul Allen. It made billionaires out of its founders and multimillionaires out of thousands of its staff. And it created two of the most lucrative monopolies in American histo-



JOCHEN SIEGLE/POLARIS

But is information from those blogs getting to you?

I have lots of sources of information about what's going on at the company. I think I have a pretty good pulse on where we are and what people are thinking. I'm not sure blogs are necessarily the best place to get a pulse on anything. People want to blog for a variety of reasons, and that may or may not be representative.

In interviews and on blogs, some employees say that you've instituted bureaucracy that is hampering innovation so much so that they question whether you should be CEO. What's your response?

At the end of the day, the proof is in the output. Do we have the innovation output? Do we have the market share? Do we have the customer satisfaction? And do we have the talent? So you go through each one of those things and say, how are we doing? Numerically, we've grown from 18% of the profits of the top 25 companies in our industry to 23% of the profits of the top 25 companies in our industry over the last five years. Profits are up over 70%, where the industry profit is up about 35%. Pretty good.

How are we doing in terms of talent? We've brought on fantastic new talent. You look at our performance in campus recruiting. We're the No. 1 choice among computer science students at U.S. universities as a place to work. You look at market share. Virtually every business we're in, our market share is up over the last five years. If you look at any of the critical dimensions, our company has performed well and I'm bullish about how we will drive that to continue.

You talk about your performance. Why has that not been better reflected in the stock price?

I think our stock is attractively priced, and we're buying our stock. That's the ultimate expression of our view. I think our stock represents such a good value that we told people we'd buy about $30 billion of it over four years on behalf of our shareholders.

BusinessWeek online For an extended version of the Q&A with Steve Ballmer, go to businessweek.com/extras

ry—one of them, Windows, so powerful that it ultimately brought trustbusters down on the company.

Now, strange as it seems, those monopolies are at the root of the company's malaise. As Microsoft fought the federal government and litigious rivals, it developed an almost reflexive instinct to protect Windows and Office, sometimes at the expense of looking for groundbreaking innovations. "Every time Bill and Steve made a change to be more like other big companies, we lost a little bit of what made Microsoft special," says a former Microsoft vice-president.

One reason some employees say Microsoft isn't innovating enough: It's too busy upgrading Windows. With some of its key breakthrough features gone, Vista's improvements include better handling of peripheral devices, such as printers and scanne and cutting in half the time it takes to start up. Those are ne ed improvements, and there's no doubt that hundreds of millio of copies will be sold as people upgrade to new PCs. But changes are hardly the stuff of cutting-edge software engine ing. "So much of what Microsoft is doing right now is main nance," says Mike Smith, a former software architect at Micros who left the company in 2003 to work for a Bay Area startup.

And that leads to an even more worrisome problem: disco tent among its software programmers. Instead of coming with the next great technology, Microsoft programmers have cater to its monopolies. But top-flight engineers want to tac the next great challenge. "They want to create new worlds,

MYSTERY BLOGGER

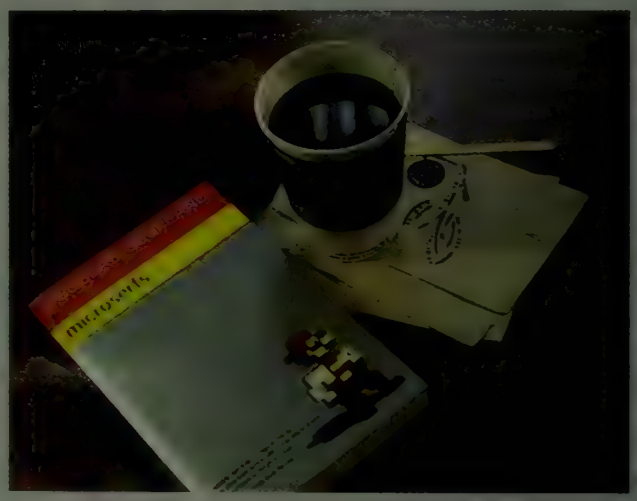
A Rendezvous with Microsoft's Deep Throat

I didn't have to change cabs twice and slip into the shadows of a suburban parking garage at 2 in the morning. Instead, we agreed to meet at a Starbucks at 5:45 pm. The signal: My contact would have a copy of *Microserfs*, the legendary 1995 book about employee life in the early days of Microsoft Corp. Sure enough, when I walked in the door, the book was sitting on the table to my right. My heart raced. "Mini?" I said, extending my hand. "It's great to put a face with a name."

The proprietor of the Web log called Mini-Microsoft may be the most notorious blogger on corporate life. For more than a year, Mini has been a thorn in the side of the software giant, posting a stream of anonymous critiques of the company, Mini's employer. Mini pulls no punches, calling Microsoft a "passionless, process-ridden, lumbering idiot" in a Sept. 4 posting. Yet the blog is also chock full of humor, intelligence, and earnest suggestions for fixing Microsoft.

While Mini-Microsoft (minimsft.-blogspot.com) is just one among an estimated 2,000 blogs operated by Microsoft staffers, it has become a virtual water cooler for employees. Hundreds anonymously vent their frustrations there without fear of retribution. Mini has emerged as something of a folk hero. Visitors to the site and other bloggers describe Mini as both the employee most likely to save Microsoft—and most likely to be fired.

Mini provides a fascinating example of a phenomenon that's sweeping the nation. Employee bloggers are shining a bright light on the inner workings of their companies and thrusting all sorts of bottled-up frustrations out in the open. Whispered conversations suddenly become broadcast publicly. That puts a huge amount of power in the hands of employees—for good or ill. Instead, the balance of power between employer and employee may be shifting. Analyst Charlene Li of Forrester Research advises companies not to try to suppress their bloggers. "You can keep it hidden, or get those voices out there and deal with the problem," she says.



Microsoft is a "passionless, process-ridden, lumbering idiot."

—Blogger Mini-Microsoft

Not surprisingly, it took some coaxing to get Mini to sit down with me. The meeting came with one condition: continued anonymity. So we started with some ground rules. "Can I at least disclose your gender?" I ask. "Sure," the soft-spoken Mini says, laughing. For the record, Mini is a man.

Mini knows, though, that he's a marked man. He might lose his job if the top brass ever figured out who he is. "They'd have to consider the bad publicity of firing me," Mini says. Still, there's that uneasy feeling that they would cut him loose anyway, if only to send a message. Prior to our meeting, he had never told anyone outside Microsoft of his double life. Not even his wife. "She has enough stress," he says.

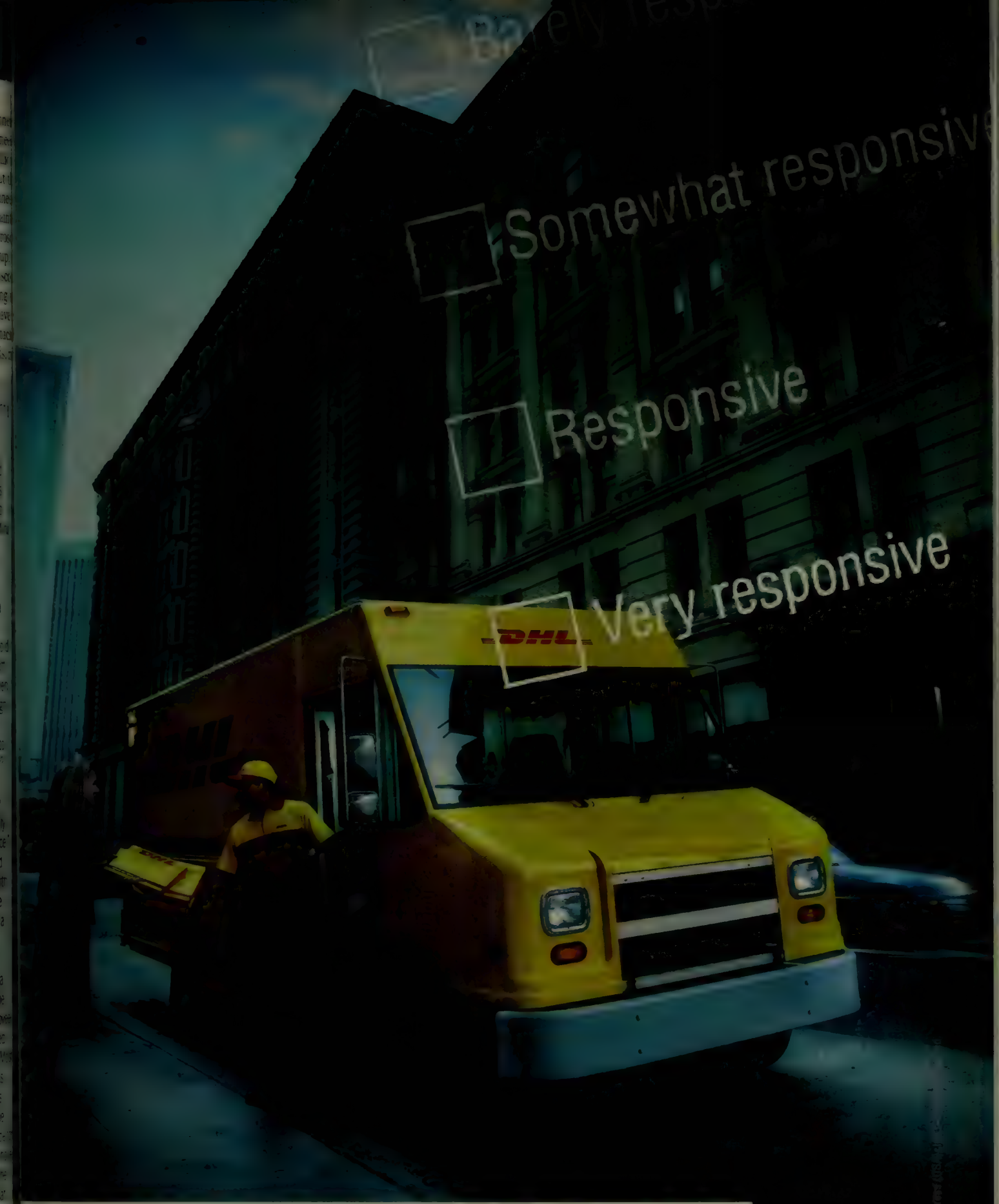
So why risk a career to vent about his employer? "Microsoft has been wonderful to me. I really want to improve it. I really want to make a difference," he explains. Mini started posting in July, 2004, with little expectation that he would develop much of a following.

He doesn't track the number of visitors, but a recent missive about the unfairness of the employee-review system generated more than 150 replies. Most seemed to come from fellow Microsofties.

Mini sometimes worries that his posts might cause Microsoft some harm, but he believes it's more likely that he'll be a force for much-needed change. "Sometimes you have to destroy the village in order to save it," he says. He just hopes it doesn't come to that.

–By Jay Greene in Seattle, with Heather Green in New York

BusinessWeek online For an extended version of this story and excerpts from the Mini-Microsoft blog, see businessweek.com/extras.



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Not-So-Crazy Suggestions

Last spring two Microsoft researchers sent a 12-page memo to Bill Gates titled "Ten Crazy Ideas to Shake Up Microsoft." An edited selection:

"Break Up" the company: Not really. But achieve the same effect by making businesses more independent, without as much concern for how they fit in with Microsoft's overall strategy.

Empower incubation projects: Set up and fund business incubators. Allow these independent outfits to start new businesses, so more new ideas see the light of day.

Schedule unscheduled time: Like Google, Microsoft should set aside a slice of every employee's time so they can think creatively about new business ideas, rather than simply following orders from supervisors.

Cut back on bureaucracy: Create "bureacracy police" who investigate complaints and cut red tape.

Reduce staffing of large projects: More people can mean slower progress. Move engineers off large projects and into incubators.

Encourage risk-taking: Give employees "shares" issued by individual business units and let them cash the shares in if their group tries something new and succeeds.

defend old ones," says a former senior executive at Microsoft. "They want to storm the Bastille, not live in Versailles."

If Microsoft loses too many top developers, it will be hard-pressed to succeed in the new markets on which it has pinned so much hope. Google, for example, embarrassed Microsoft in October, 2004, by coming out with software that lets users quickly search the files on their Windows desktop before Microsoft released its own version.

Adding to employee frustration is the company's bureaucracy. After Ballmer became CEO, he put in place processes he hoped would help manage a bigger organization better. But instead of liberating employees to do great work, Ballmer's moves have been stifling, some workers say. With so much effort placed on cross-group collaboration, employees spend more time in meetings making sure product strategies are in sync. The company schedules executive product reviews several times a year, and preparing for them is hugely time-consuming. That prep work cuts into the more interesting work creating new technologies and products.

SWEATING THE SMALL STUFF

TO BALLMER'S CHAGRIN, some of his up-and-coming programmers have left for Google. He was apoplectic about Lucovsky's departure, according to documents made public during the Lee trial. Lucovsky said in a sworn statement that after he told Ballmer about his plans to move to Google, the beefy CEO threw a chair and cursed Google's chief executive. "F__ing Eric Schmidt is a f__ing pussy. I'm going to f__ing bury that guy.... I'm going to f__ing kill Google," Ballmer said, according to Lucovsky. In a statement, Ballmer calls Lucovsky's account "a gross exaggeration of what actually took place."

Some workers express frustration that Microsoft is so busy protecting its PC-based businesses that it comes up short when competing on the Web. Take the customer relationship management (CRM) market—software that companies use to track sales and customer service activities. Microsoft targeted it 2½ years ago with a traditional software package, Microsoft CI Today roughly 4,000 companies run the software for ne 100,000 staff. Not bad, but Microsoft hasn't been nearly as s cessful as Salesforce.com Inc., a trailblazer of Web-based C software, with 308,000 users at 17,000 companies.

The secret to Salesforce.com's success: the speed with wh it can update its software. Microsoft last updated its origi CRM software in January, 2004, with plans for a new versio first quarter, 2006. Meanwhile, Salesforce is constantly fix bugs and adds features without interruption to the custome added expense. All customers need to do is open a Web bro er to run the program. Microsoft CRM boss Brad Wilson arg that business software is complex and best sold as a pack that customers run on their own computers. "This is re about business process where you've got multiple steps," W son says. "It is a much more extensive thing that often requi a lot of people, a lot of time, and a lot of resources."

While upstarts like Google and Salesforce have Microsoft the defense, the biggest threat to the company may be its o moves. With revenue growth slowing, Ballmer has tried squeeze more down to the bottom line to make the comp more appealing to investors. In the past fiscal year he slasl $2.6 billion out of operating expenses. But that came at a pr Microsoft sliced health benefits, introducing, for example, a $ copayment on some brand-name prescription drugs. Withi week of announcing the benefits proposal in May, 2004, hun resources received 700 e-mails. Of those, 80% were negat and fewer than 1% were positive, according to an interna mail obtained by *BusinessWeek*. One employee wrote in ar mail: "Small things like this chip away at employee loyalty morale and in the long run do more harm than benefit."

Even the cuts that seem trivial have dampened morale. J whisper the word "towels" to any Microsoft employee, and e roll. Last year, Microsoft stopped providing a towel service workers who used company locker rooms after bike rides workouts. Employees who helped the company build its h cash stockpile were furious.

And don't even mention stock options. Employees long cou ed on them to bolster their salaries. Microsoft minted thousand employee millionaires as the stock climbed 61,000% from its 1 public offering to its peak in 2001. Now shares are trading exa

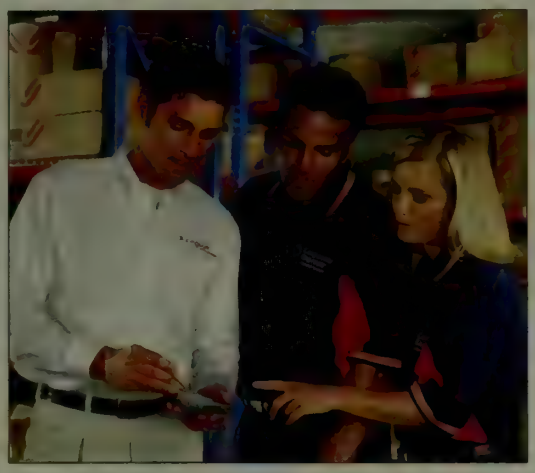
WORK
gest and fastest
l wireless data network.
gest U.S. provider on
bal standard.

EXPERTISE
Our people and partners make wireless work for more businesses than any other wireless carrier.

APPLICATIONS
The broadest and deepest portfolio of wireless business solutions.

SERVICE
24/7 enterprise-grade support. And a service staff dedicated solely to business people.

real time gets Corporate Express there in no time.



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were they were seven years ago. Microsoft has doubled its payroll in that time, adding more than 30,000 new employees, not including attrition. That means more than half of Microsoft's employees have received virtually no benefit from their stock holdings. Instead, they're working for a paycheck and not much else.

And even if the stock does begin to climb, employees won't hit the kind of jackpot their predecessors did. Two years ago Microsoft stopped issuing big dollops of stock options, retreating to more modest helpings of stock grants. The idea was to help retain workers by giving them a sure thing—stock with some value, since so many options were underwater. Meanwhile, 90% of the tech industry still rewards employees with stock options.

GATES As chief software architect, he's responsible for product development

RECRUITING SLACK

MICROSOFT'S COMPENSATION MOVES have created a haves-vs.-have-nots culture. Newbies work for comfortable but not overly generous wages, while veterans have a lucrative treasure chest of stock options. Now a new pay scheme, scheduled to go into effect this fall, threatens to make the gulf even wider. If they meet incentive goals, the 120 or so vice-presidents will receive an eye-popping $1 million in salary a year, and general managers, the next level down, will get $350,000 to $550,000, according to a high-ranking source. But the rest of the staff is paid at market rates.

The pay disparity is exacerbated by Microsoft's rating system. The company uses a bell curve to rate employees in each group, so the number of top performers is balanced by the same number of underachievers. But Microsoft has a long history of hiring top-notch computer science grads and high-quality talent from the industry. Under the rating system, if a group works hard together to release a product, someone in the group has to get a low score for every high score a manager dishes out. "It creates competition in the ranks, when people really want community," says a former Microsoft vice-president. A company spokesman says managers don't have to apply the curve with smaller groups, where it's not statistically relevant.

Even on college campuses, long a fountain of talent for Microsoft, the tide seems to be turning. On Sept. 7, Massachusetts Institute of Technology's Science & Engineering Business Club held its annual recruiting barbecue, with about a dozen companies setting up booths to recruit as many as 1,500 students. "There was a lot of buzz around Google table and not a lot around the crosoft table," says Bob Richard, asso director of employer relations at How much? When Richard wa through, he says, students were line six deep to talk to Google recruiters, w only two students stood at the Micr table. Carnegie Mellon's Reddy says top students opt for Google and Ya ahead of Microsoft these days. Micr points out that in a survey conducte market researcher Universum, the c pany ranks No. 1 among computer ence students as employer of choice.

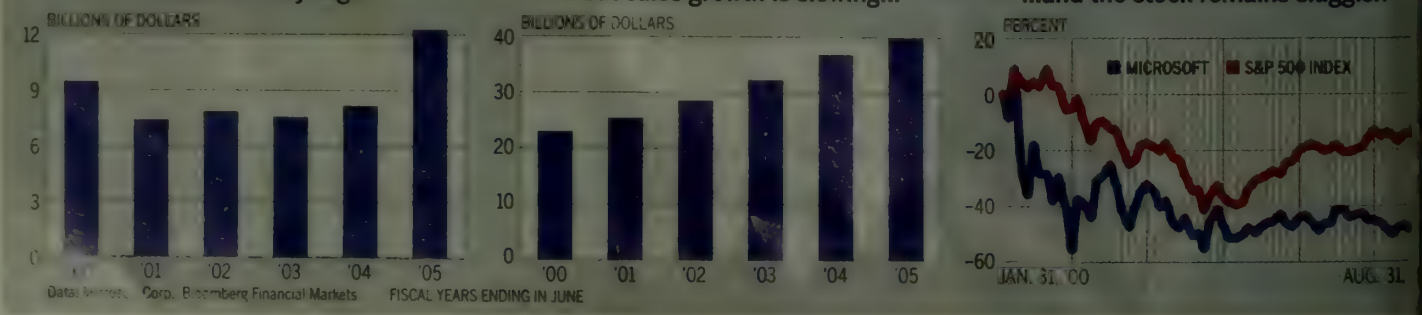
Microsoft is hardly the first com to struggle as it moves from adolesc to maturity. And it could learn some sons from others that have made transition more gracefully. Take Ge Electric Co. The conglomerate has boasted an entrepreneurial culture, hundreds of managers running fie independent businesses. Those leaders are given free rein are held accountable for their own results—meaning they get the boot if they don't perform. "The process is transpa and rigorous and constantly reinforced," says Noel M. Tic University of Michigan professor and leadership guru.

Ballmer says Microsoft is finding its way through the c lenges of being a more mature company just fine and tha complaints of some employees simply reflect the kind of co ny Microsoft is. "We have for ourselves incredibly high exp tions," he says. "And that's in some senses is the greatest b ing and opportunity anybody can ever have. Our people. shareholders, me, Bill Gates, we expect to change the wor every way, to succeed wildly in everything we touch, to hav broadest impact of any company in the world. It's great th saying: 'Come on, we can still do better.' Great." Ballmer sm his meaty hands together for emphasis. "We need those hig pectations."

Microsoft certainly is chock-full of smart employees want to do better. Still, many of them say that jumping thr bureaucratic hoops and struggling to link products togeth preventing them from being the best they can be. There's a for action to Gates and Ballmer to do more—slash the bur cracy, tend to morale, and make it easier to innovate. But is one listening? ■

–With Steve Hamm, Diane Brady, and M Der Hovanesian in New

MICROSOFT'S MIXED BAG



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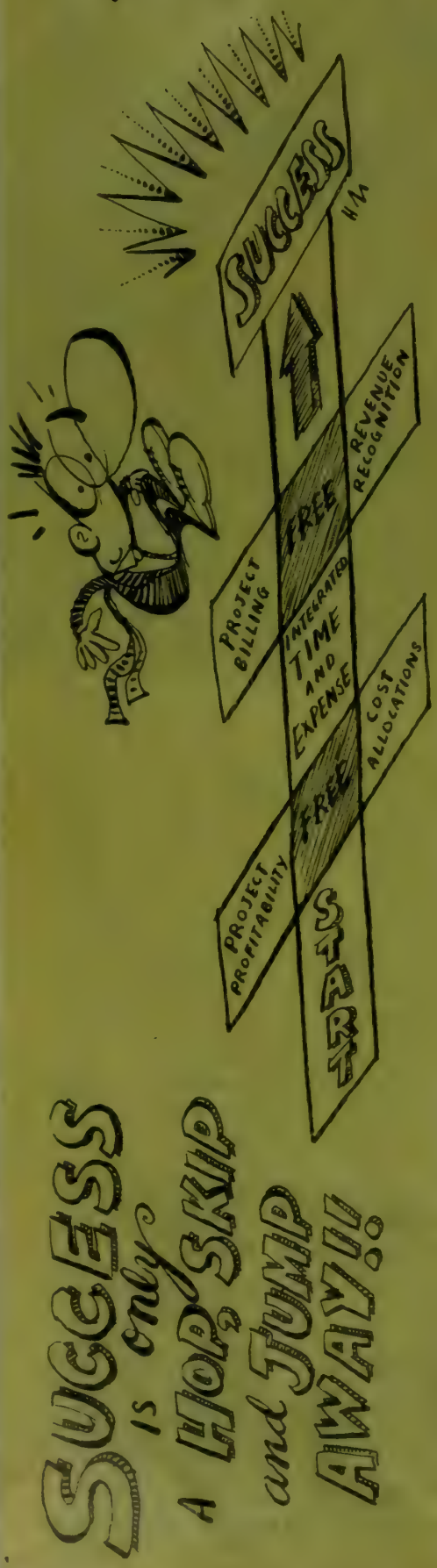


IN GAZA KinderUSA helps children overseas

Taking the Taint Out of Giving

Islamic charities are trying to win back donors spooked by fears of fed scrutiny

LAST JANUARY THE BOARD of Dallas charity KinderUSA made an unusual request to its 6,800 donors: Please don't send gifts. The Islamic charity, which delivers food and aid to children in war zones, had just received a federal grand jury subpoena asking its officials to turn over all meeting minutes, tax returns, and other documents. It feared that the government could freeze its assets or seize its list of donors at any moment.

After four months with no word from the FBI about whether KinderUSA was being investigated, the board resumed fund-raising. But board chair Dr. Laila Al-Marayati worries for her donors, who want to support charity but fear b caught up in a terrorism investiga "Charities are in the position of b guilty until proven innocent," she "Our donors are afraid. They don't k what to do." (The FBI would not con or deny an ongoing KinderUSA inves tion when contacted by *BusinessWee*

Donors and charities alike have re to be on guard. Since September 11 f al authorities have frozen the assets o Islamic charities in the U.S., inclu three of the largest, for alleged link terrorist groups—in effect, shutting groups down. The U.S. Treasury D which is charged with cutting off m tary support for terrorists, has froze assets of 41 aid organizations glo

alleged connections to terrorism. This spotlight on the Muslim charita- sector may well be warranted in the ne of national security. September 11 ced an awakening to the reality that Qaeda, Hamas, and like-minded ter- ist groups have abused charities to port hate-filled agendas," according to peech by Juan Carlos Zarate, who was ently appointed deputy national secu- advisor for combating terrorism after int monitoring terrorism financing at Treasury. Nevertheless, he U.S. marks the fourth iversary of the Septem- 11 terrorist attacks, none the investigations has n resolved. The charities' ets remain frozen.

Meanwhile, these in- ries resonate powerfully oss the Islamic charity tor, shifting the direction millions of dollars as ors fret that giving to or- ized Islamic charities ld lead them into a legal rass. Muslim Americans now looking for methods ond traditional charitable ng to fulfill *Zakat*, a pillar Islam, which requires slims to give 2.5% of r income to the poor.

More Muslim Americans deciding to bypass chari- entirely in favor of giving ctly to those in need. sider Mark Mohammadi, started a Middle Eastern aurant in Dallas. Out of that he'll unwittingly tribute to a group that is ed to terrorist activity, decided to stop giving ey to charities. To fulfill charitable obligation, he es about 30 meals nthly to homeless people. Mohammadi: "After 9/11, I don't t anyone." Ahmed Syed, a Pakistani migrant and a retired quality control nager for the Defense Dept.., takes a rent approach. "My family abroad do- s on my behalf to causes in Pakistan, hospitals and general education," the Walnut Creek (Calif.), resident.

o bring donors back, charities are em- ing new measures to prove that their k is legitimate. KinderUSA has gained putation among Islamic charities for l governance and transparency and s audited financials on its Web site. such measures did little to prevent a formal inquiry, and Al-Marayati remains frustrated by how little she knows about the inquiry's status.

Such situations have led Muslim-American leaders from more than 20 Islamic charities to unite to find a solution. Last March they launched an umbrella organization called The National Council of American Muslim Nonprofits that will offer a seal of approval to charities that meet their criteria, which are still being developed. The council is working closely with the Treasury Dept. to ensure rigorous standards that will offer some protection to donors and charities.

Charitable Tradition

To fulfill *Zakat*, one of the five pillars of Islam, Muslims are required to give to the poor

4

The number, in millions, of tax-paying Muslim Americans

2.5%

Percentage of annual income Muslims are asked to give to the poor

$6

An estimate, in billions, that Muslim Americans donate to charity annually*

*Calculation based on average income of $60,000

Data: Muslim Public Affairs Council

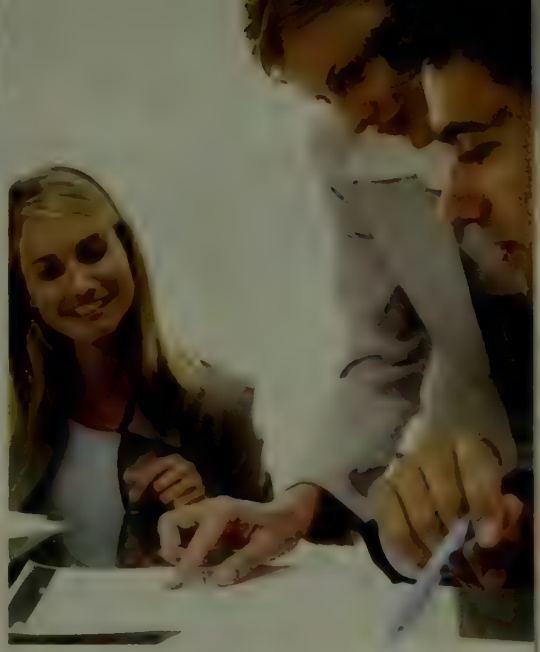
UNDUE BURDEN

BUT SOME SAY the council, with its rigorous application process, could put an undue burden on charities without offering them much in return—such as the assurance that if they meet all the standards they won't be pulled into a probe. Treasury Dept. spokesperson Molly Millerwise says the seal won't shield charities from the possibility of investigation. "Donors want a vetted list of charities. We can't provide that," she says. "Who is to say if charities engage in terrorism-related activities after they're put on the list?"

Tiny nonprofits also may find it costly to comply with the reporting required by the council, which will likely address issues such as transparency, audit triggers, and board makeup. Karen Keyworth directs the Islamic Schools' League, which represents the U.S.'s 215 Islamic schools. She worries that the financial strain of meeting tough transparency measures might force schools, many of which have minuscule budgets, to cut operations.

Still, Keyworth says that efforts such as the council's are needed to persuade donors to keep giving. Unfortunately for Muslim Americans anxious to see the legitimate groups that serve their communities thrive, greatly increased scrutiny—and the bureaucratic hoops that come with it—may be the new order in a post-September 11 world. ■

–By Jessi Hempel, with Bremen Leak, in New York



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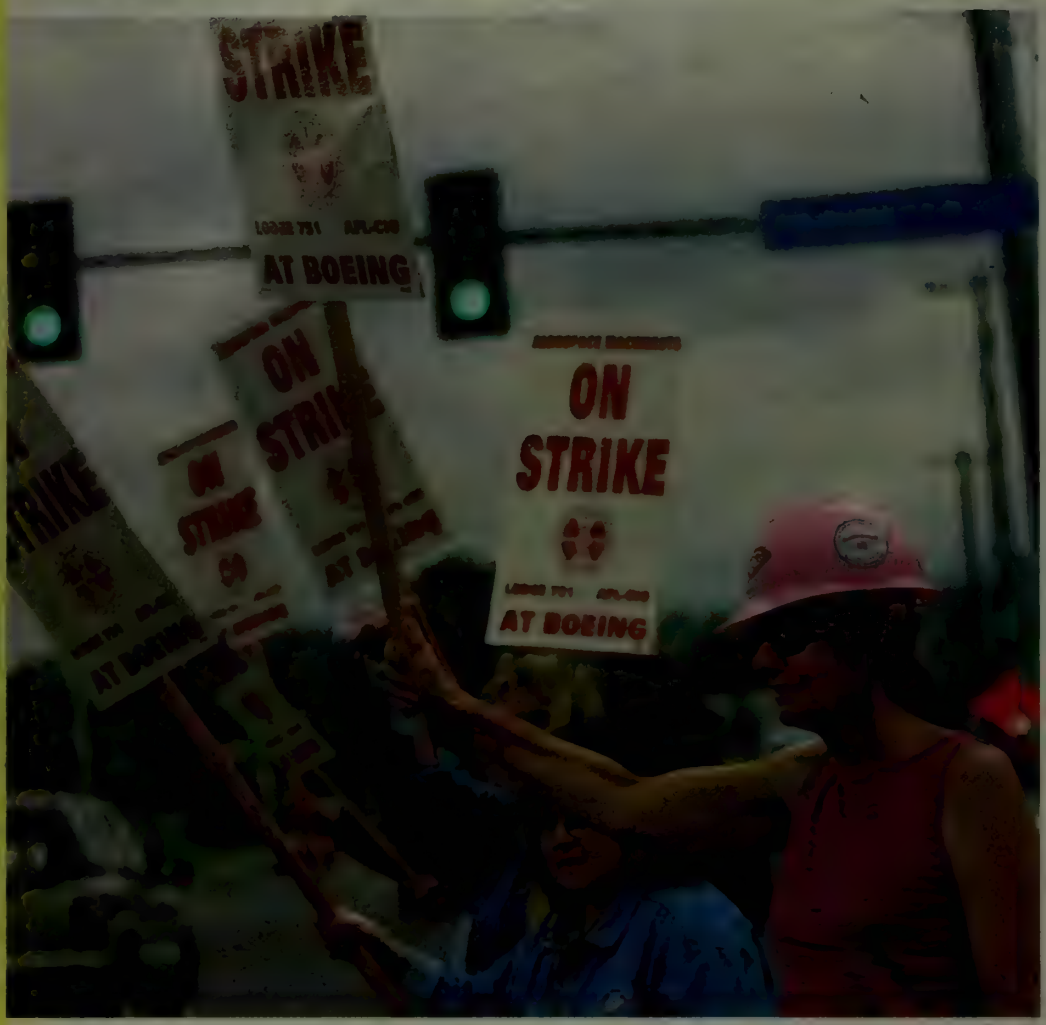

AUBURN, WASH. Boeing has a history of troubled labor relations

Boeing's Strike: Go Figure

The shutdown is costing much more than it would to meet the machinists' demands

IN THE DAYS BEFORE BOEING Co.'s 18,300 machinists walked off the job on Sept. 2, management thought it had a smart strategy for avoiding a strike. True, the aerospace giant wasn't ready to back up its traditional defined-benefit pension plan nearly as much as the International Association of Machinists (IAM) was demanding. But Boeing had an alternative: Offer as much as $9,000 in cash bonuses, including a generous new match to the 401(k) that IAM members get along with their pension. Managers hoped the juicy stack of cash would tempt the roughly 4,000 mostly younger workers who had been recalled recently as orders picked up. If so, that would have sufficed to bring about a repeat of 2002, when the IAM failed to muster the two-thirds majority needed to sanction a strike.

Instead, Boeing's effort misfired badly. The machinists rejected the company's offer by 86%. Boeing Commercial Airplanes CEO Alan R. Mulally, who's running the show while new Boeing CEO W. James McNerney Jr. learns the ropes, denies that the company attempted to divide the union membership. Still, what's puzzling is why he hasn't yet found a face-saving way to end the standoff. A close reading of management's offer suggests that it could cost the IAM's key pension demands for $90 million more over the three-year life of a new labor contract. Since that comes to less than 1% of the nearly $4 billion the company will spend on the IAM's wage-and-benefit expense over that period, it's difficult to see what Boeing has to gain by a lengthy showdown. This is particularly true in light of analysts' estimates that Boeing will rack up more than $90 million in costs each month that the walkout drags on.

FAT ORDER BOOK

WHAT WORRIES Wall Street is the long history of bad blood between Boeing and its unions. In 1995 the company endured a 69-day strike that poisoned morale for years. This contributed to a series of painful production snafus over the few years that the company [illegible] billion—a profit stretch that lasted right through [illegible] then was the biggest boom in commercial aviation. Today demand is once more rising for jetliners, raising concerns that Boeing will [illegible] let labor animosities get in the way [illegible] boom times. "The money makes no material difference to either side—there's no reason for this strike to be happening," says Richard Aboulafia, an analyst at aerospace consultant Teal Group.

While Boeing's initial strategy seemed promising enough, Mulally and Boeing Human Resources Vice-President [illegible] Calhoun clearly underestimated the machinists' desire for traditional pensions. Indeed, two-thirds of IAM members are nearing retirement and weren't tempted by the short-term cash offer. Instead, older workers are looking for a big boost in the pension plan that currently pays [illegible] $60 a month per year of service—[illegible] $1,800 a month for a 30-year veteran. Boeing offered to bump that up to $[illegible] 2008, but the IAM is looking for $8[illegible] $70 at the least, union insiders say. [illegible] workers, says IAM District 751 President Mark Blondin, feel they deserve a [illegible] retirement as payment for helping Boeing rebound from the worst slump in commercial airplane history. They also [illegible] that the Chicago company is sitting

"If you see money in your code, you want to protect it. If you don't, then you want it liberated."

— Dana Blankenhorn, ZDNet Open Source Blog

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more than $5 billion in cash and has earned more than $1.1 billion in profit in the first half of this year.

The question now is, if the strike is costing more than a compromise would, why doesn't Boeing just settle? True, no industrial company wants to saddle itself with even higher fixed pension costs these days, given the pain that General Motors Corp. and others are going through with their troubled union retirement plans. But in Boeing's case, the extra dollars it would take to satisfy its aging IAM workforce amount to a pittance.

MULALLY
Needs to find a way to end the standoff

WISH LIST

INTERNALLY, MULALLY has argued that meeting the IAM even halfway would be disastrous. In an early September e-mail to managers, he said union negotiators had barely moved off their original positions when the strike began and "were demanding $1 billion more than what was in our best and final offer." Mulally went on to say that meeting the "union's extreme positions" would have been a "disservice to every current and future employee, customer, and shareholder...and would have eroded our ability to compete."

The pension plan pays a 30-year veteran $1,800 a month

But it's difficult to make his numbers add up, according to accounts of the talks from both sides. The $1 billion Mulally cited includes every demand the IAM made; in other words, its negotiating wish list. But unions almost never get everything they want, and their leaders know it. They're negotiating—starting high in the hopes that a compromise will yield a better deal. Demanding $1 billion in wage and benefit hikes would nearly double Boeing's IAM payroll, something Blondin says he knows would never happen.

In fact, the differences between the parties boil down to something closer to $90 million, according to union and company data analyzed by *BusinessWeek*. The company's pension offer of $66 a month would add $16 million a year to its pension outlays, or $48 million over the contract's three-year term. The $80 the IAM wants would hike that to $29 million a year, or about $90 million through 2008. Union negotiators say they probably would have settled for something closer to $70 a month had Boeing bee willing to keep talking. Boeing disput the idea that the pension issue alo could solve the standoff.

The company's current offer, which i cludes a pay hike and a more modest pe sion increase, would cost it about $27 million over three years. That comes to a increase of less than 2.5% a year, a gre outcome given all the new plane orde pouring in to Boeing. Even matching t union's full pension demand would bun that total up to only $360 million, ju about equivalent to the 3% a year ma economists expect inflation to be. "Ob ously, we came to the table with significa increases, but they were unwilling compromise and didn't bargain," clai Blondin. Boeing officials deny that IA negotiators suggested any compromise

Underlying the current standoff are t poor relations Boeing has long had wi the IAM. That became clear in last-minu talks between Calhoun and Blondin ju before the strike began. The two we deadlocked over yet another relatively m nor issue, involving worker trainin Blondin recalls asking: "I just don't unde stand why you always fight us." Blond says Calhoun replied: "You just don't g it. We represent Corporate America. Y represent labor. We are always going to adversaries." Boeing says Blondin's a count was taken out of context.

Whatever the exact figures, the sum causing the impasse are essential rounding errors for a company that hau in $54 billion in annual revenues. Wi any savings to Boeing soon to be eaten in the strike's first month, what's rea driving Boeing remains a mystery. ■

–By Stanley Holmes in Seat

Does Boeing's Math Add Up?

Commercial Airplanes CEO Mulally says meeting workers even halfway would be disastrous, but the monetary difference between the two positions is actually small, and the strike is expensive:

Cost of Boeing's offer on the table now

$270 million over three years

Cost with higher pensions

$360 million over three years*

Difference

$90 million over three years—or less than 1% of the machinists' total wage-and-benefit expense of $3.9 billion

Cost of Strike

$90 million a month

* BusinessWeek estimate

Data: BusinessWeek

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meet the CEO of section 15

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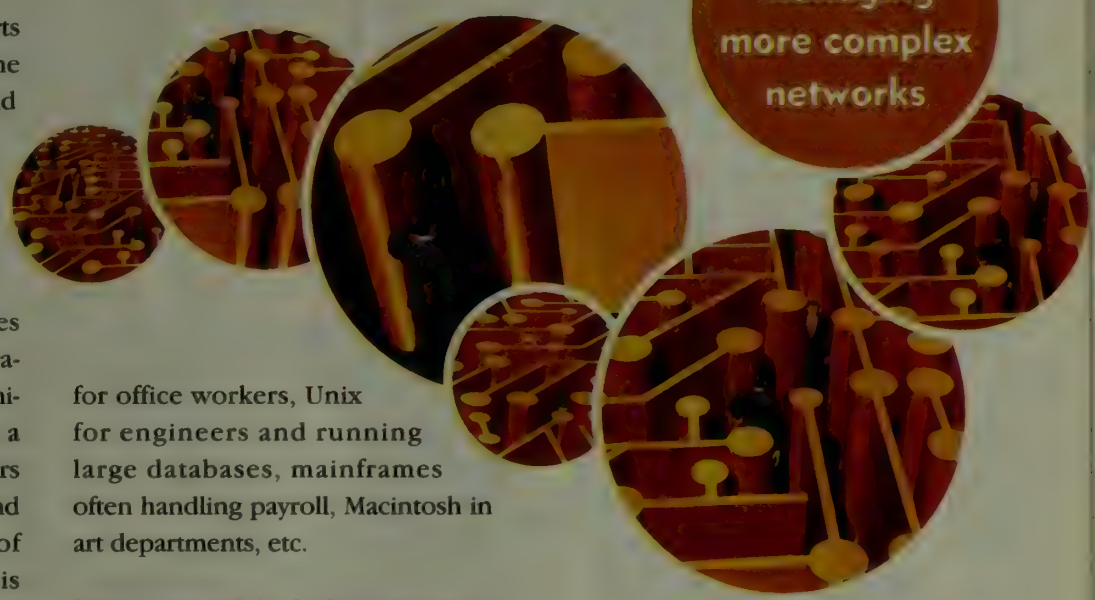


f the road to hell is paved with ood intentions, then it's fair to say hat the road to well-intentioned infrastructure improvements is paved with ell. At least that's the sense from the eople who have to make these systems ork together.

Not that most infrastructure experts oday would have it any other way. The dvances in flexibility, performance and telligence analysis far outweigh the ain in making the move, but the xperts do stress that it takes care.

Arthur Gruen is a partner with ilkofsky Gruen Associates, a telecomunications consulting firm that does e annual market review and IT infrastructure forecast for the Telecommuniations Industry Association (TIA), a ade association representing providers f communications and IT products and rvices. He says the top positive of oday's complicated infrastructure is at there is "more of an opportunity to stomize. It's still difficult to do, but fore it was almost impossible."

For years, systems were dominated ith the early legacy form of proprietary stems. In the 90s, multiple operating stems became the enterprise norm, t they were proprietary outside of eir niche. That wasn't initially much of problem because companies tended to gregate those operating systems by ork area, with Windows office suites for office workers, Unix for engineers and running large databases, mainframes often handling payroll, Macintosh in art departments, etc.

Interoperable Infrastructure

But today's infrastructure is becoming truly interoperable for operating systems, which is where things get more complicated. Networks are changing, moving away from the private networks that dominated much of the 20th century to data and telecommunications networks riding over the public Internet.

"There are a lot of proprietary systems that didn't interoperate with each other. Back then, you simply didn't have that many alternatives. You could really customize and get the applications and features you want," Gruen says. "You can now do all kinds of different things. You can do more in terms of creating your local networks and integrating phone systems and putting them all on one network. But it's become hellishly complicated."

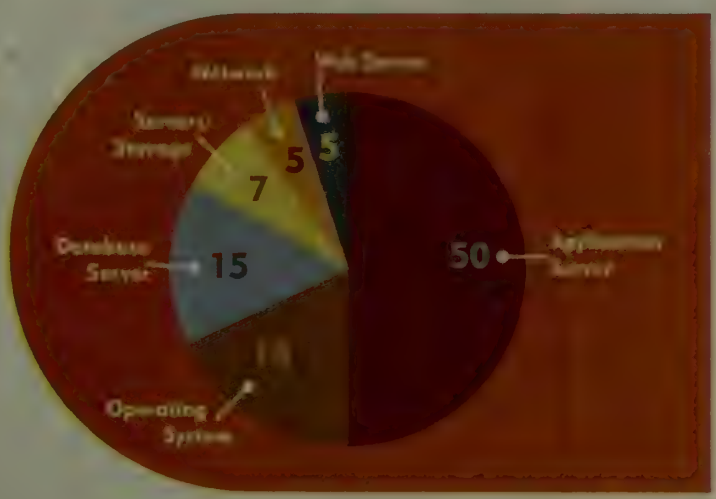
Indeed, as enterprise infrastructure becomes more complex—and more flexible—strict adherence to global standards becomes more essential. That rigid adherence to standards, however, comes at a steep price: new restrictions on customization.

This is not to suggest that customization will go away. But companies that have gotten used to years of staff programmers tweaking applications and having systems talk with homegrown applications written in-house are going to find a bumpy road ahead.

Where Do Network Problems Usually Hide?

As networks get more complicated, service disruptions can come from an increasing number of places.

(% of reported problems)



Source: Integrien Corp.

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"Businesses will always require customization no matter what anybody says," says Roman Pacewicz, an AT&T vice president for enterprise networking. "There are certainly situations where (customization) is totally justified and users are willing to pay the price for that. Certainly, if you do not follow or adhere to industry standards, it is quite commonplace for costs and complexity to soar."

It's not merely hardware, software and networking standards that are crucial to watch, Pacewicz says, but global and Internet standards, too. "The ability to take full advantage of emerging market revenue and cost opportunities globally is crucial, especially as IP capabilities start to soar over the next year or so. As a practical matter, a proprietary environment simply won't allow you to do that."

Mike Yates is the director of service development at Insight Direct USA, a division of Tempe, Ariz.-based Insight Enterprises Inc., a $3 billion systems integrator. He says customization is absolutely one of the major causes for the infrastructure difficulties companies are enduring today. But he also said much of the pain is self-inflicted.

Referring to the IT community in general, he says, "We did it to ourselves. We have CIOs who say, 'The way we do it here at Company X is the best way it's ever been done, even if it's dysfunctional.' That's the way corporations have been buying IT for 30 years."

Yates points to major customization projects as the single biggest problem. "There's been a lot of short-sightedness all around. People buy and sell the needs of the moment and don't think about the future. That's why we had Y2K," he says, quoting a typical CIO saying, "'Because of requirements that need to get filled immediately, my environment has grown into this monster that I cannot manage.'"

One approach to minimizing future infrastructure pain is to closely watch both networking trends and an IT department's likely future capability needs. "You need to understand what kind of connectivity options are coming around. Don't design yourself into a corner," Yates says.

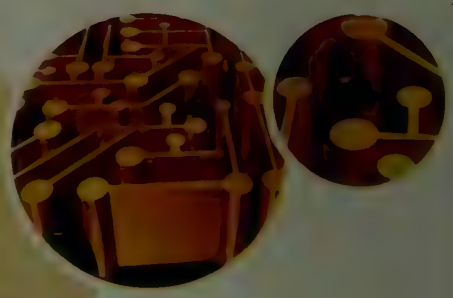
He also agrees that strict adherence to standards is more crucial than ever. "People buy these large application and customize them and then things change and they have to reenginee everything," Yates says. "There are some well-established standards. You deviate away from them at your own peril. Stop taking technology that was well designed to function in a certain way and then customizing it to do something else. The industry can't support a constant series of one-offs."

Vendors have always dominated technology standards bodies, with a few end users periodically participating. Damon Wei, an AT&T group manager says he would encourage end-user company executives to start playing a much more active role with the standards bodies, which means they must donate some of their talented technical people to attend a lot of faraway meetings.

"Not only do you need to adhere to standards, but you need to participate in the creation of standards," Wei says.

Indeed, he adds, it's possible that some end-user companies could use the

Infrastructure Resources



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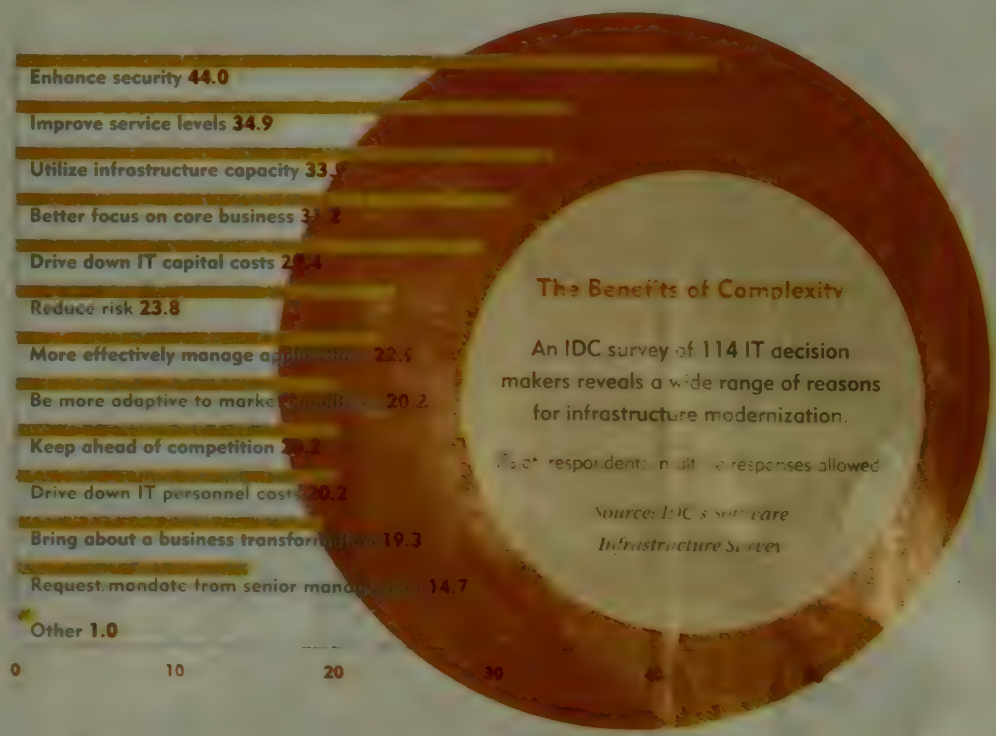

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standards process to sneak in some customization. If one company wanted to have inventory updates handled in a very specific way, for example, instead of customizing that approach, it might be able to convince a standards committee that its approach is better. If the company is persuasive enough, that standards committee participation could deliver its customization as part of an accepted industry-wide standard.

"If you participate in the creation of those standards, you can perhaps influence the development of those standards," Wei says.

Rapidly Diversifying Audiences

Rapidly diversifying audiences are also impacting infrastructure complexity today, with intranets and extranets continuing to grow quickly and steadily. The recent surge in popularity of the virtual private network (VPN) and the corresponding tidal wave of security threats is forcing greater encryption.

But those expanding networks are adding flexibility and saving dollars, positioning companies to cut costs as well as take advantage of upcoming technologies. That's important, as the numbers of intranet users (including remote sites, corporate telecommuters and the traveling employee) and extranet users (suppliers, distributors and large customers) continue to grow.

Global operations are becoming more typical, too, even for companies that would not be considered traditional multinational operations. Those newcomers to the global stage include U.S.-only retailers who are finding their Web presence attracting overseas prospects, American firms selling only to American consumers but who are discovering lower cost Asian suppliers, and U.S. operations outsourcing helpdesk and programming functions to India.

"As that occurs, it just takes the current problems you have and extends them geographically," Wilkofsky Gruen Associates' Gruen says. "You simply have to do more integrating than you did before."

That also forces even more standardization on a company, which is tricky because the world markets are far from standardized. "Europe does stuff their way," he says, referencing the popularity of the CDMA wireless approach in the United States while Europe prefers GSM, and "you have a lot of different things going on in Asia," with China and South Korea using their own proprietary wireless approaches.

It's not necessarily bad, though. "Because of those networks and new undersea cables, you have a huge capacity now and you can transmit things back and forth pretty quickly. You can even have back-office operations in another country," Gruen says. "You can move resources around and have more choices, but it's also much more complicated."

This makes things especially difficult for the IT executive who is expected to project investments out a couple of years.

Wireless Acceptance

One of the reasons these infrastructure choices are likely to get much more complicated is the growing world of wireless acceptance. From wireless LANs bypassing construction needs as well as adding flexibility to high-powered phone-hybrid PDAs for mobile workers to warehouse radio frequency identification (RFID) applications to retail contactless payments, wireless has the most potential to rewrite the way corporate technology is deployed and used.

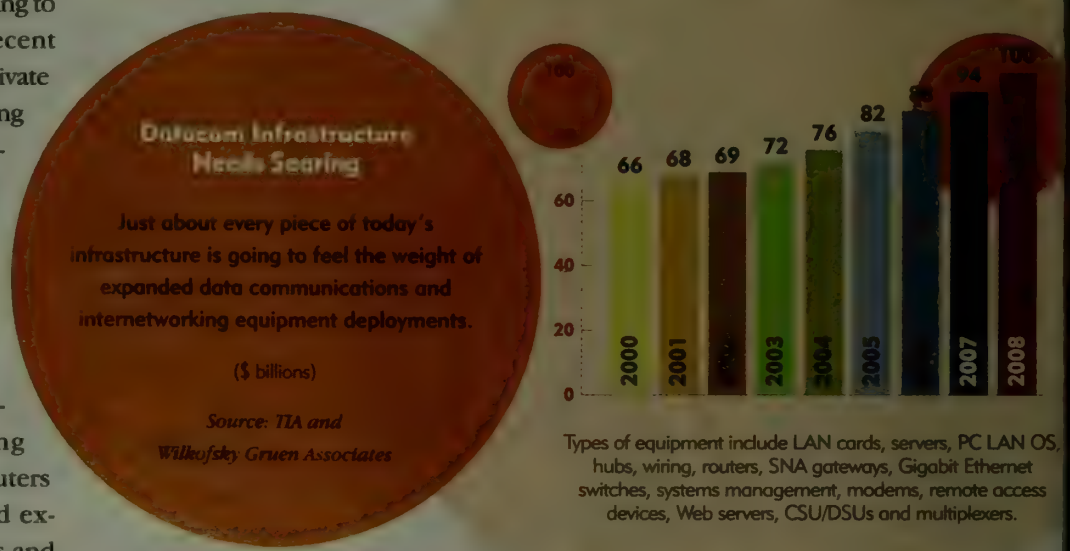
Raghu Rau, a Motorola senior vice president, predicts that the cost of wireless communications will drop by a factor of three and that data speeds will increase.

The reliability may be initially weaker, though, not so much because of technology issues but because of cost issues. "Physically, it may be possible to have the same level of reliability as wireline," Rau says. "But the business case will make it too expensive to provide the same level of coverage."

But Rau says he expects reliability to increase as a result of the use of hybrid phones and Wi-Fi devices, because both will be designed to automatically shift between protocols, formats and other standards. If one network gets weak, the device will shift to another network. "There will be a quantum jump in the reliability of wireless networks," he says.

Whether wireless networks will ultimately prove easier to manage and secure is an open question. But whether to have wireless networks is now considered a corporate fait accompli.

Management of wireless LANs is "fairly straightforward" for most companies, including the monitoring of access point utilization and throughput, says Tom Hayes, a product marketing director at Computer Associates. "WLAN monitoring is now typically part of the



Types of equipment include LAN cards, servers, PC LAN OS, hubs, wiring, routers, SNA gateways, Gigabit Ethernet switches, systems management, modems, remote access devices, Web servers, CSU/DSUs and multiplexers.

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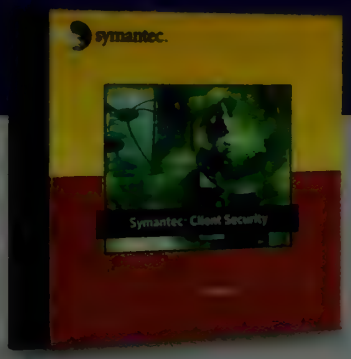

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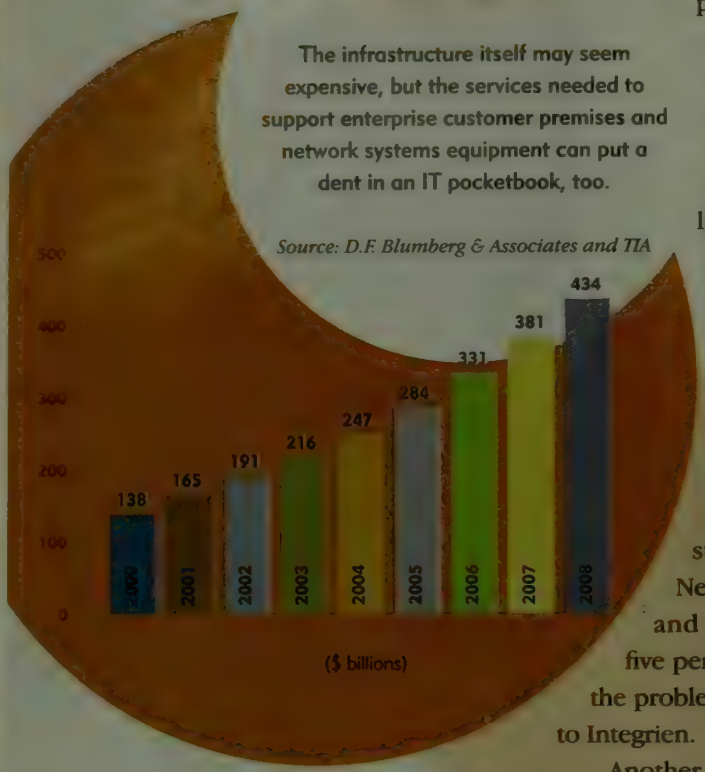

The Cost of Supporting Tomorrow's Infrastructure

The infrastructure itself may seem expensive, but the services needed to support enterprise customer premises and network systems equipment can put a dent in an IT pocketbook, too.

Source: D.F. Blumberg & Associates and TIA

conversation we have with customers about infrastructure management," he says. "Several years ago, WLAN was not part of the conversation."

But wireless is still going to be difficult for most IT executives to resist. "Wireless is a requirement today. It is no longer 'a nice to have,'" says Matthew J. Flanigan, president of TIA. "It makes individuals more efficient and makes a company more competitive."

Not only is the wireless world reaching broadband speeds, but more of the wired world is, too. Flanigan argues that imminent faster wireless speeds will make management of a wireless network's data potentially easier than its wired counterpart. "Once more fiber is deployed, then we'll see higher speeds," he says. "Once we're in a truly broadband world, that will change how everyone does everything."

Multiple Points of Failure

The core of the problem is that today's typical IT infrastructure has many points of failure. Of the major components that make up the IT infrastructure, "the applications and databases account for 65 percent of the problems," says Mazda Marvasti, co-founder and chief technology officer of Integrien, a system management tool provider in Irvine, Calif. The next most likely source of infrastructure failure lies with the operating system, which comes in at 18 percent.

The hardware, it turns out, is the least troublesome, even though that is where many companies focus their infrastructure reliability efforts. Network components, servers and storage only account for five percent and seven percent of the problems, respectively, according to Integrien.

Another infrastructure challenge is that companies need to prepare for rapid growth. Sheer scalability and complexity can create problems. For example, many applications no longer sit on one centrally-controlled server, says Ori Inbar, vice president for SAP Netweaver product marketing.

Adds Bill Wohl, SAP's vice president for global communications: "In today's economic environment, rip-and-replace projects won't sell to boards of directors. Quick returns and projects that leverage existing skills and investments are the IT projects that will be funded."

The challenge of creating a reliable and scalable IT infrastructure goes beyond focusing on any one—or even several—components of the infrastructure. Maintaining a reliable infrastructure entails seven disciplines, says Kenneth Smith, executive vice president of strategy and software at Sungard Availability Services. The company divides those seven disciplines into two groups, disciplines that deal with the physical infrastructure and those that deal with the management of the infrastructure.

There are four physical infrastructure disciplines: technology, physical facil the network and people. The technol discipline focuses on the hardware a software. The physical facility discipl addresses the computer room, envir mental concerns (HVAC) and power. T network discipline involves the mo ment of data around the enterprise a beyond. With human error as a comm cause of infrastructure failure, "we people as a physical resource that must managed," Smith says.

Sungard identifies the three m agement disciplines as operations, in mation and applications. The operati discipline addresses such issues maintenance and patch manageme The information discipline deals w issues like security and backup a recovery processes. The applicati discipline focuses on the managem of the applications themselves.

Investment Pays for Itself

To the extent that today's infrastruct struggles are self-inflicted from ye of ignoring standards and shortsigh customization, it's also true that tod executives can reverse that trend. W the lure of seamless global netwo lightning-fast wireless and applicati that can scale without breaking, so companies might even recover fr their infrastructure headaches just l enough to recoup their investments focus on business objectives. The in structure challenge might still b headache, but at least it's one that c panies are supposed to have. ●

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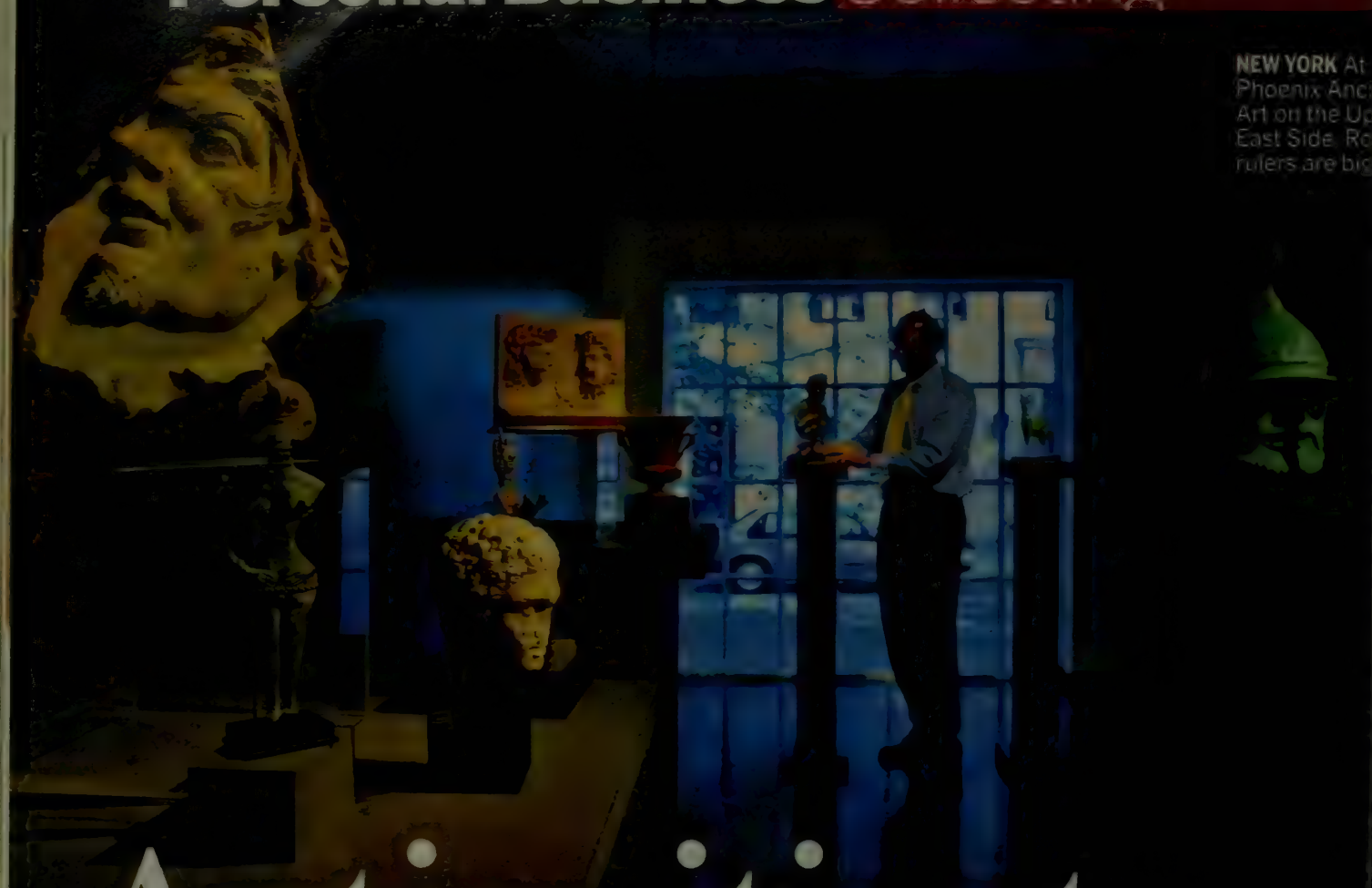


NEW YORK At Phoenix Anci Art on the Up East Side. Ro rulers are big

Antiquities to Grow Old With

As new controls on illicit trading bite, the interest in ancient art treasures is on the rise—and so are the prices. BY MARA DER HOVANESIAN

PEOPLE HAVE BEEN LIVING IN the ancient lands of Gandhara, a remote mountainous region that stretches across northern India, Pakistan, and Afghanistan, since at least the sixth century B.C. The region was home to Prince Siddharta Gautama, the original Buddha. Later it was a haven for Chinese refugees fleeing Huns, as well as a conquest of Greece's Alexander the Great. In the mid-1990s, it was the place that touched off Hunter Lipton's obsession with collecting antiquities. Lipton, a Manhattan real estate developer, holds a piece of that rich history in the palm of one hand as he cradles a small sculpted head the size strawberry and made of indigen schist, a greyish-green metamorp rock. They once adorned monasteries were made to depict monks and their tendants. You might think a 2,500-y old artifact like this, a gift from Lipt father, is priceless. In fact, five such pi together cost the elder Lipton just $2, in 1994. "You can spend $1,000 or $1 lion, but it's still hundreds of years and it always has a great story behind says Lipton, 38, who has since accu lated about 25 pieces in a collection

ludes Byzantine bowls and fragments Roman statues.

Antiquities are a tiny part of the giant market. But they are starting to attract v interest from collectors and in- tors—especially for artifacts from me, Greece, and Egypt that date from Stone Age to about the 1st century). Why now? A crackdown on the ck market for art and antiquities—a e third to drugs and weapons traffick- —has spawned tighter controls on the v of what is already a finite supply. s, countries such as Italy, China, and key are becoming more vigilant about serving their cultural heritage and e adopted strict export rules. So, what wned by galleries and private collec- today is all that can be traded—at t legitimately.

URN TO THE EAST

INDLING SUPPLIES and rising de- nd have already sent prices soaring. t-sellers at a Sotheby's December an- ities sale in New York included a nze head of Ptolemy of Mauretania, a nber of Roman royalty, circa 520 A.D. mated at first to be worth up to 0,000, it sold for a record $960,000. istie's anticipates some $20 million in quities sales this year from four auc- s, compared with $4 million in 1995. Christie's auction in New York on 8, a 5,000-year-old Anatolian (west- Turkey) marble statue eight inches the *Stargazer*, sold for $1.8 million— cord for such an idol (table). A keen rest among Westerners about Far tern religions and practices—such as a and tantric healing—is also spilling into the antiquities world, says Selim e, gallery owner of Fortuna Fine Arts ew York. "There's not much Gandha- stuff for us to buy," he says, "so things up 25% in the last two years, easily."

ollectors don't need big bucks to get ted. One-of-a-kind Byzantine gold elry pieces thousands of years old are parable in price to the latest designs n Tiffany & Co. selling for $5,000 to 000. Glass and bead necklaces from tern Asia dating from the 1st century sold for less than $1,000 at recent ions. Hicham Aboutaam, co-founder hoenix Ancient Art in New York, says an rulers such as Augustus or rius, as well as Greek vases signed by artists, are big, yet "people are sur- ed how affordable they are."

hile the antiquities market is still fairly inscrutable, new tracking services are expected to shed more light on authenticity and pricing. Artnet.com—a database providing auction results starting in 1985—will soon add stats on worldwide antiquities sales from private galleries and auction houses. "It will help establish prices more universally so people can be more comfortable with their purchases," says Brian McConville, Artnet's director of sales.

Until then, the best way to start is to figure out what is off limits. Check out the U.S. State Dept.'s Web site at www.exchanges.state.gov/culprop. It will tell you which countries have either bilateral agreements or emergency rulings. The site has an image database that provides pictures of restricted artifacts. Also, check objects against The Art Loss Register, an international database of lost and stolen art at artloss.com.

In general, the more that's known about art and where it has been, the more valuable it is. An object's provenance, or ownership history, would ideally trace it from the archeological site through its different owners. The danger: Even if a work has been acquired legally, it could be seized by authorities because its documentation isn't adequate. "The laws are extremely complicated and changing all the time," says Patty Gerstenblith, a professor and specialist in cultural property law at DePaul University. But you can buy objects that predate national ownership laws and any bilateral agreements between the U.S. and the country of origin if ownership can be traced for at least a couple of decades, she adds.

The best protection? Buy only from dealers who offer money-back guarantees. Most collectors receive a "warranty of authenticity," which validates the year or period of the artwork. But that's not enough. Buyers must ask for indemnification from the seller so that if anyone brings a claim of ownership or improper importation, the purchase is fully refundable. "Simply, if the government comes and seizes it, you want to be refunded your money," says Gerstenblith.

Antiquities sales don't usually grab headlines like those of modern art. Picasso's Garçon à la Pipe, for example, set the art world abuzz last year when it sold for $104 million. But if antiquities haven't been caught up in hype, that's good news for collectors. Opportunities still abound to get into the market before the door shuts tight. ■

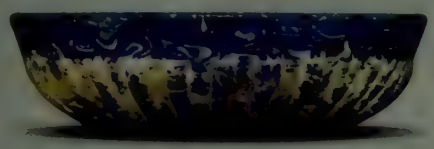
The Glory That Was Greece

Egyptian, Roman, and Anatolian art is also hot, as governments crack down on the black market

ANCIENT JEWELRY OR PENDANT

A Roman onyx cameo portrait of the Emperor Claudius, 41-54 A.D. Its price set a world auction record for an ancient cameo. This one was sold out of a private collection.

DECEMBER, 2004: $321,000



ROMAN MOSAIC GLASS RIBBED BOWL

Mosaic glass was created starting in the 2nd century B.C. in Greece, but a desire for such products led to similar workshops in Italy.

MAY, 1975: $18,000

JUNE, 2005: $192,000

ANATOLIAN MARBLE FEMALE IDOL

Only about 15 such figures exist. Many were broken during burial rituals dating from 3300-2500 B.C.

JUNE, 1989: $345,700

JUNE, 2005: $1.8 million

Road Warrior Weight Loss

Lugging too much? Lighter electronic gear lets you shed pounds. BY CLIFF EDWARDS

A LITTLE OVER A YEAR ago, I decided to lose some weight. Not from my waistline, mind you. My ever-growing collection of electronic travel essentials had been weighing me down, and on a trip to Europe I managed to slash 25 pounds worth of laptop, battery, cords, cameras, adapters, and chargers to just 10 pounds.

The rapid pace of change got me thinking: With new devices that combine functions or add features, maybe I could upgrade, consolidate, and lighten my load further. After searching around, I found seven new pieces of equipment I could carry with me instead of last year's 10. By swapping gear I use constantly and jettisoning one fairly hefty device I rarely use—a 4.6-pound travel printer—I took another six pounds off the package.

First, I replaced my 2.6-lb. Sharp Actius MM20P notebook computer. After rejecting a 2.1-lb. Toshiba Libretto U100 because the keyboard was too cramped, I went with Toshiba's R200 Portégé. This machine is so thin, I thought the box was empty when it arrived. Even though it was one ounce heavier than the Sharp, it

1. PLANTRONICS PULSAR 590 $199, 3.45 oz. Plug this Bluetooth stereo headset into your MP3 or video player for amazing sound.

2. TOSHIBA PORTEGE R200 $2,000, 2.6 lbs. A featherweight package, offering built-in Wi-Fi, and plenty of speed.

3. TARGUS UNIVERSAL NOTEBOOK AC ADAPTER $90, 11 oz. A versatile power supply for a variety of gadgets.

4. CANON POWERSHOT SD400 DIGITAL ELPH $300, 4.5 oz. This 5-megapixel point-and-shooter takes excellent stills.

5. MOTOROLA RAZR V3 $200 with cellular contract, 3.3 oz The sleek phone offers text messaging, a camera, and Web access.

6. IPOD NANO 4GB DIGITAL MUSIC PLAYER $249, 1.5 oz. This tiny gadget lets you sync Outlook and Mac contacts and calendar.

7. CORPORATE SECURITY KEY $50, less than 1 oz. Access e-mail from any Web-connected PC or laptop.

8. SLING MEDIA SLINGBOX $250, 1.5 lb. Plug into your TiVo or cable box at home, and stream shows to your laptop.

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offered two more inches of screen space and a built-in SD card slot to read data, pictures, or music.

The hardest decision I made was to ditch my beloved Treo 650 handheld phone organizer (6 oz.) for Motorola's 3.3-oz. Razr V3 phone, which also lets you browse the Web and take pictures. With the Treo gone, I had to think of another way to keep track of my contacts and schedule. That came with Apple Computer's September release of the iPod Nano digital-music player and iTunes 5.0 software. At 1.5 oz., the featherweight player is surprisingly heavy on features. You can download music and color pictures from your PC and Mac and add your Outlook contacts and calendar. In part because of the Nano, I shed nearly 1.5 lb. as I dropped the Treo and Archos' AV400 pocket video recorder, a hard-drive player that let me listen to music and watch TV shows.

TV IN YOUR LAP

A QUICK THINKER might note that the Nano, with its tiny 1.5-inch screen and 4 gigabytes of flash memory, isn't really suited to video. That's where Sling Media's Slingbox comes in. You attach this gizmo to a TiVo, TV, or set-top box at home and use the Web and your home network to watch programs on a PC or laptop. While the setup was not as easy as I would have liked, the technology will eventually go a long way toward lightening the entertainment components of a traveler's load.

As for upgrades, I'm happier with my new 4.59-oz. Canon PowerShot SD400 Digital Elph camera, which replaced a 6.3-oz. Sony Cyber-shot DSC-T1. The advantages: The Canon has a regular viewfinder, fewer pictures come out blurry, and its SD memory card lets me look at pictures on my laptop screen instead of on the 2-in. LCD screen.

Finally, I traded bulky Bose headphones used to block out travel noises for a Plantronics Pulsar 5900A Bluetooth stereo headset. It comes with adapters you can plug into MP3 players, notebook PCs, Bluetooth-compatible cell phones, and airplane sockets.

After all this, I wound up with a total weight of 4 lb., including the 11-oz. Universal Auto/Air Notebook Power Adapter kit from Targus that I kept from the last go-around. If I were paying for the items instead of using demo units, the whole lot would cost $3,338, including the Slingbox. That's $19 less than last year's tab, still a reasonable price to take some of the load off your back. ■

2006 ML500
Longer, lower, and wider

The SUV Refined

Mercedes' new M-Class vehicles are sleek and roomy—and drive like a car. BY LARRY ARMSTRON

GONE ARE THE BOXY looks and rough-and-tumble ride. The new Mercedes M-Class SUV is longer, lower, and wider, with a more graceful shape and a whisper-quiet ride that approaches that of the company's luxury sedans.

The previous M, launched eight years ago, popularized the idea of sport-utility vehicles for the mid-luxury set. But it was built like a pickup, with separate body and frame. It also had a chintzy interior and was plagued with reliability problems. It was eclipsed by more carlike rivals, such as the Lexus RX and BMW 5 Series.

This thirsty SUV gets 19 mpg on the road and 14 mpg in town

There are two versions of the new M-Class: I drove the top-of-the-line ML500 around Los Angeles for a week. The new single-piece, unibody frame—just like a car—gives it a much more refined ride than its predecessor, soaking up bumps, and its lusty, 302-horsepower V8 provides more than enough thrust. Steering is firm and controlled, but as with most SUVs, the car leans a lot around quick corners.

The new M is nearly six inches longer, and that length is put to good use: Front and rear passengers have two more inches of leg room, and there's an additional six cubic feet of cargo space. A full complement of safety gear is stand antilock brakes, stability and trac control, and side and curtain airbags

Huge, circular vents in the d along with a TV-like display for cont ling entertainment and navigat dominate the interior. Mercedes mo the gearshift from the console (repla it with better cup holders) to the stee column; it controls the seven-speed tomatic transmission, a first in an SU doesn't work like a conventional shi but I found it easy to used to. Tap it up for verse, down for drive, push a button on the en the stalk for park. A p lem: Two stalks on the side of the column, for t signals and cruise con are easy to confuse.

Despite the new tr mission, which impr fuel economy by 11%, isn't a particularly th car, getting 19 miles gallon on highways and a paltry 14 in the city. Then there's the price: ML500 starts at $49,275, and a long of high-cost options—including a $1 suspension, $1,290 sunroof, $520 pc tailgate, $1,080 CD changer, or $4 for sportier bumpers and wheels—easily add 15 grand. For my money start with the V6-powered ML350 $40,525. It's nearly as quick, and le you with almost $9,000 extra to sp on those luxury necessities. ■

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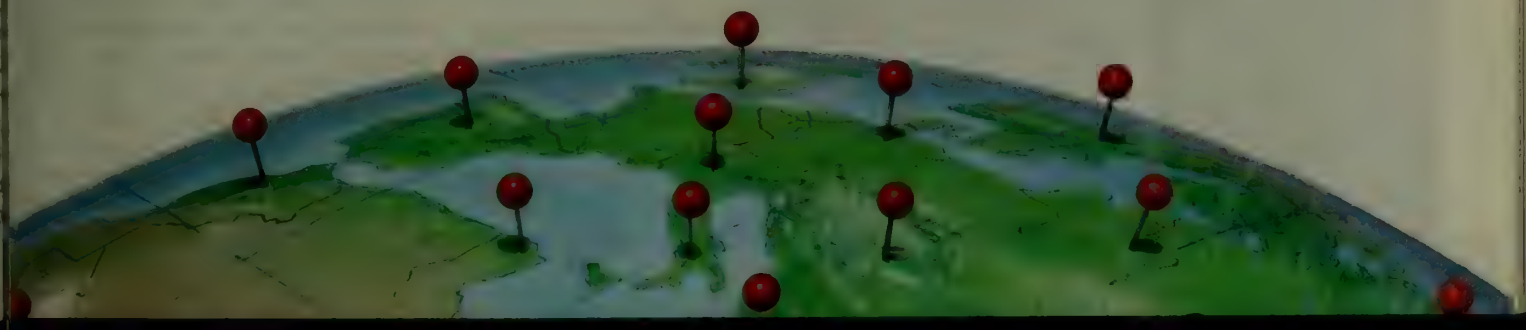

Scotch Whisky For the Rest of Us

Distillers are trying to lure the uninitiated by adding more familiar flavors. **BY GERRY KHERMOUCH**

SCOTCH WHISKY DRINKERS are used to serious old-world names such as Glenfiddich, Laphroaig, and Lagavulin. So where do The Rich Spicy One, The Smokey Peaty One, and The Smooth Sweeter One fit in? These three new malts from Jon, Mark & Robbo's Easy Drinking Whisky Co., which are just hitting store shelves, represent an attempt by some distillers to demystify a sometimes intimidating spirit and bring new drinkers into the fold.

It goes beyond the names. The new-generation Scotches offer novel blends, or they finish the whisky in casks that have been used to produce sherry, Cognac, or Bordeaux wine. The resulting flavors are often more accessible to the uninitiated than the traditional smoky varieties. Distillers hope these flavors will lure consumers who are drawn to the "white spirits" such as vodka and rum. "People always want to try what's new—and most of the new stuff is very good," said Warren Radford, a whisky buyer at New York's Astor Wines & Spirits.

EASIER DRINKING Jura's Superstition plus two malts from Jon, Mark & Robbo

One of the best examples is Jon, Mark & Robbo's Easy Drinking Whisky. In 2002, Scottish brothers Jon and Mark Geary approached David Robertson, former master distiller for the Macallan label, about creating some whiskies that ordinary people could relate to. The 80-proof Smooth Sweeter One, for example, obtains a unique, vanilla taste by throwing lighter Irish whisky into the mix. At $30 per 750-milliliter bottle, it doesn't cost much more than a popular blended Scotch whisky such as John Walker Black.

Another relative newcomer, Isle Jura Distillery's 90-proof Superstiti ($40), is winning admirers for its abi to combine the smoky, peat flavor ass ated with malt from the Islay islands the Hebrides region of Scotland with more floral qualities of malts from Highlands. "Even an established whi drinker may have tried a big, sm whisky like Laphroaig, Lagavulin, or A beg and shut that door very quickly," s Isle of Jura's master distiller, Willie T "So we found a way to marry two w derful styles."

PEAT FIRES

SUPERSTITION COMES in a striking b tle with a cinched waist and an Ar cross embossed on it. The name refer an old Scottish belief that it's unlucky to cut the peat in April instead of in May. (Drying the malted barley over peat-stoked fires is what gives this whiskey its distinctive character.) The cross represents the divine power of immortality, or so it says on the label.

> Aging in sherry o Cognac casks imparts new tast

Other distillers are attaining new vor notes for their products—and try to pique the interest of wine drinker by supplementing the traditional ag of their whisky in bourbon barrels wit few months of finishing in barrels u for sherry, Cognac, or wine. Gl morangie pioneered the technic about a decade ago by using made sherry, and port barrels. More recentl has brought out a 12-year-old whisky ished in burgundy casks ($40) that h fresh, light character.

Bruichladdich, a once-shuttered c tiller in the Islay region that has b undergoing a revival since it was bou and reopened in 2001, is applying c finishing touches to the fine stocks new owners uncovered. Golf lov might want to check out its limited-e tion bottlings commemorating fam courses. The third annual release is a year-old named Royal Troon that finished in sherry casks ($80 to $9 The label sports a rendering of the mous British Open site by renowned landscape artist Graeme W. Baxter makes a fine gift for any golf nuts Scotch newbies you know. ■

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TANDARD
POOR'S

Wheels of Fortune

These superbikes are ultralight, durable, blazing fast—and incredibly expensive. **BY AARON PRESSMAN**

CHRIS CURVEN AVIDLY followed Lance Armstrong's seventh victory in the Tour de France this summer along with millions of other fans. But for the 34-year-old amateur racer and his cycling buddies in Walpole, N.H., the tour is more than just a sporting event. It's also a home shopping channel of sorts for superbikes: Yes, those ultra-pricey, high-tech machines ridden by Armstrong and his colleagues can be ordered from a specialty bike shop near you.

This year's tour had plenty to whet the appetite. Armstrong rode several new models from Trek Bicycle of Waterloo, Wis., designed on a supercomputer to combine maximum pedaling efficiency and minimum aerodynamic drag. Lorenzo Bernucci of the Fassa Bortolo team won Stage 6 aboard Pinarello's Dogma model that can sell for up to $16,500 at speci shops. And the Phonak team relied o new design from Swiss maker BMC t uses nanotechnology to lower the wei of the carbon frame without reducing strength. When Curven saw Phona BMC bikes, which the company lists more than $8,000, he had one immedi thought: "Why don't I have that?"

Sales of road bikes at specialty sh have doubled to $377 million since 20 even as overall bike sales have remai flat, says the National Bicycle Dealers As The gains are being led by a dramatic crease in the most expensive bikes, s marketing consultant Jay Townley.

By paying upwards of $10,000, seri riders get a machine that's lighter, m aerodynamic, and more efficient at tu ing a rider's effort into speed than low priced models. They also get a bike t handles better at high speeds do winding roads and absorbs more of bumps from the road.

Bikes that Trek and others sell in $1,000 to $3,000 range provide so of those benefits. With superbikes, get only a marginal improvement weight, but for some aficionados, t and other minor gains are worth

What Goes Into a **$10,000-Plus** Machine?

The frame, of course, is the costliest item. But top-flight components set you back a pretty penny, too

WHEEL AND SPOKE The $2,700 Campagnolo Bora G3 uses an unusual aerodynamic rear spoke pattern.

THE REAR DERAILLEUR The top bikes use either Shimano's Dura-Ace set or, as here, Campagnolo's Record group. Either adds about $1,500 to a bike's price.

CARBON-TITAN FRAME JOINT S combines the b absorbing qual carbon with the strength and ro of titanium.

BOTTLE HOLDER An $80 carbon cage that just looks cool.

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added costs. Pinarello's $4,100 Dogma frame weighs 2.8 lbs., vs. 3.1 lbs. for its Prince model that costs half as much. Adding wheels, gears, and the other components can push the full weight of a superbike up to 15 lbs., vs. 18 lbs. for a cheaper one.

ROUGH PAVEMENT

THE PREMIUM BIKES also carry an undeniable cachet. Craig Calfee, who made the carbon fiber bike that Greg LeMond rode in the 1991 Tour, sells only about 100 of his handcrafted frames a year. The market's highest end is divided between longtime European companies such as Pinarello and Colnago, and American craftsmen like Calfee, based in La Selva Beach, Calif., titanium specialist Ben Serotta in Saratoga Springs, N.Y., and Bob Parlee in Peabody, Mass. The bikes are sold mainly through local dealers, which are listed on each maker's Web site.

James Overall, an ad executive in Concord, Mass., has about a dozen bikes, mostly from similarly fastidious small designers. Each is different, with some handling rough pavement better and others more comfortable for long rides. "They reflect the idiosyncratic views of the builders," he says. The bikes are "half machines and half works of art."

The most basic question that confronts a high-end buyer is the choice of frame material. Once only made of steel, frames now use titanium, aluminum, carbon fiber, or some combination. Titanium and carbon are the most expensive and hence dominate the upper echelon. Both are stronger than steel, so a bike frame can be made lighter.

Many bike shops lend out pricey machines for local test drives

Carbon frames, made of the same material used in space shuttle parts, can be refined by manipulating the fibers into different patterns. The best combine stiffness and flexibility. Stiff parts translate more of a rider's energy into turning the pedals, while more flexible sections are designed to absorb bumps. Riding a well-crafted carbon frame brings a floating sensation because there's little wobble from the rider's efforts or the bumps. Stomping down on the pedals to go into a sprint produces a pleasingly quick, get-up-and-go sensation.

The latest frames combine several ingredients to further fine-tune the ride. Calfee added boron to strengthen his Dragonfly frame without increasing the weight. Trek's Madone SSLx bike, which Armstrong rode to victory this year, also mixed boron and carbon. Coming to a bike shop near you next year, it's likely to sell for even more than the $7,700 current issue, plain old carb Madone SSL. One of t priciest bikes on the mark the $17,000 Pinarello Do ma Ego, uses magnesium loy tubes. Lighter than al minum or titanium, t material is almost impos ble to bend or dent. Serot famous for his titaniu frames, added carbon to t of the three central tubes his $5,295, top-of-the-li Ottrott frame. The carbon is placed wh bumps would jar the rider, while titaniu tubes are positioned to maximize the r er's efforts.

Some of the larger bike shops lend c pricey models for local rides, so you c see how the frames work for you. A rid for instance, may find that carbon bil absorb too much road feel, so he or s might prefer titanium or a carbon-me combo. Frames also vary in the angles which the tubes come together. Some s ups keep the rider tucked in closer to t bike for a more aerodynamic but l comfortable ride. Frames with stretched-out geometry may be easier control at high speed.

In addition to selecting a frame ma rial, you must decide whether to bu bike in a standard size or seek out one a handful of manufacturers that can c tomize the dimensions for the rider good bike shop can do quite a bit to al the fit of a bike by swapping out a few l parts or bringing the handlebars in or from the rider. "A little tweaking here a there can work wonders for most peopl says Matt Phillips, test director for *B cling* magazine. For those with unus body types—fewer than 10% of all rid estimates Calfee—a custom-made fra will provide more comfort.

The parts on a frame are almost as c ical to ride quality. In cycling's versior Windows vs. Mac, riders are split betw Shimano of Japan and Italy's Campag lo for basic gears and parts. Shimar top-of-the-line Dura-Ace and Camp Record both would add about $1,50 the price and weigh about the same. S mano is for those who want to be l Lance. Campagnolo, which uses carb in parts such as brake levers, is the cho of those favoring sharper looks. Carbo becoming the material even for parts l water cages. Putting a plastic cage o superbike "is like painting a mustache the Mona Lisa," says Andrew Clarke, v shelled out $80 to avoid that fate on Merckx MXM carbon bike. He proba shaved off a few grams of weight, too.

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EDITED BY TODDI GUTNER

HEALTH

LOTS OF SPAS ARE GETTING A MAKEOVER

THERE'S NOTHING laid back about spas these days. A frenzy of new development is giving the industry a lift:

MEN ACCOUNT FOR 29% of all spa goers, yet spas are still a woman's domain with those fruity body treatments and New Age music. To make guys feel more at home, **Willow Stream Spa** at the **Fairmont Scottsdale Princess** outside Phoenix is introducing male-only treatment suites in late September. The rooms will be like bachelor pads, with flat-screen TVs, leather furniture, and more masculine-looking robes than the standard white terry-cloth issue. And in order to free spa-shy men from having to shuttle between rooms, the suites also feature all-in-one treatment tables for pedicures, facials, and massages. The suites are coming to six other Willow Stream spas by next year.

THE REAL ESTATE BOOM is extending to spas. This fall, **Sundara Spa** in Wisconsin is opening 26 residences, and next year, **Canyon Ranch Living** will offer 442 condominiums, plus an 83,000-square-foot spa and fitness center in Miami. Check out spafinder.com/spas/realestate for more places to live and spa.

KOHLER WATERS SPA in Wisconsin is adjacent to **Blackwolf Run** and **Whistling Straits,** two of America's top-ranked golf courses. Now, Kohler is revamping a spa overlooking the 17th hole at golf's mecca, the Old Course in St. Andrews, Scotland. Scheduled to open in February, 2006, the 13,000-square-foot spa at the **Old Course Hotel** will emphasize water treatments. They'll include Cooler Near the Sea, designed to mimic the Baltic Sea's rapidly shifting weather patterns and improve blood circulation with a hot body shower followed by a cold stone massage. *–Lauren Young*

TAXES

Go Green and Save

THE RECENT $14.5 BILLION energy bill was enacted before Katrina, and the tax credit for spending on energy-saving home improvements and vehicles don't kick in unt Jan. 1. But as we're in for a long period of high utility and gas prices, the credits ca help. Energy-efficient appliances, such as dishwashers or refrigerators, won't qua According to experts at tax information specialist **RIA,** you can claim credits for:

» 30% of the cost of solar panels, plus 30% for a solar water heater. Each credit is capped at $2,000, and you've got to install the equipment in 2006 or 2007. You ca take the credits on a primary and vacation home, but not on pool or hot tub heate

» 10% of the cost of energy-saving doors, windows, insulation, and roofs, plus up $300 for efficient central air conditioners and water heaters powered by natural g propane, or oil. You can also claim $150 for efficient furnaces and $50 for energy-saving fans. The hitch: You can claim only $500 in total—with just $200 for windows—for your primary home only.

» Up to $3,400 for a hybrid car or light truck. You must buy between Jan. 1, 2006 and Dec. 31, 2010, but once your car's manufacturer sells more than 60,000 hybri the amount you can claim will be reduced.

One group loses out: taxpayers subject to the alternative minimum tax next yea You can't take the credits unless Congress changes the tax laws. *–Anne Terge*

TIME OFF

IF YOU'RE A ROCKER with champagne tastes, check out Mumm Napa Winery's Legends of Rock photo exhibit, which runs throu March, 2006, at the Rutherford (Calif.) winery (mummnapa.com). The show features images of rock icons such as Keith Richard (right) and Janis Joplin. You can also sample Santana DVX, a sparkling wine created with guitarist Carlos Santana. At $55, it's cheaper than a ticket to a concert. *–Amy Cortese*

We call it

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it usually isn't the

LAST

By 9:30 a.m. MBA students at the University of Virginia are well into their day. Perfect time then for First Coffee, a tradition dating back to the founding of the Darden School of Business. At First Coffee, students and faculty gather to discuss entrepreneurial ideas, strategies for interviewing or even to swap running routes.

But there is also a very practical side to First Coffee – THE COFFEE. With classes through early afternoon, individual case preparation, club meetings, recruiting briefings, presentations, and late night sessions with learning teams, let's just say that here at Darden, a little boost occasionally comes in handy. **www.darden.virginia.edu**

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BY GENE G. MARCIAL

WHY HYPERION SOLUTIONS IS STILL A TEMPTING TAKEOVER.

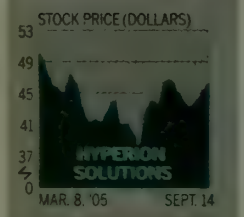
GROWTH WILL BE SWEET AT HONEYWELL'S MANY BRANCHES.

COOPER TIRE & RUBBER MAY PICK UP SPEED AGAIN.

Hungry for Hyperion?

ORACLE'S MOVE TO ACQUIRE Siebel Systems (page 32) has refocused pros' attention on Hyperion Solutions (HYSL), rumored to have been a target on Oracle's busy radar screen. Richard Parower of investment firm J. & W. Seligman, which owns shares, says Hyperion, a provider of software for business performance management, is still bait—for Oracle, IBM, or SAP. But Oracle may have to wait till it digests Siebel. Charlie Chen of investment bank Needham also says Hyperion, now at 46, is a buyout because of its strength in the "attractive growth segment of enterprise software." It helps businesses consolidate their books and comply with regulations such as Sarbanes-Oxley. Among its 10,000 customers: IBM, Citigroup, General Electric, General Motors, Novartis, Toyota, and Verizon. Both Parower and Chen figure Hyperion is worth 60 in a buyout. On fundamentals, it is worth 54, says Chen, who expects profits of $2.05 a share for the year ending next June, and $2.23 in fiscal 2007, vs. $1.90 in 2005. With a cash stash of $450 million, or $10 a share, he says the stock is cheap, based on profits and sales, relative to its peers. CEO Godfrey Sullivan won't comment on Hyperion as a target. "Our value is in helping our customers in the best possible way as a stand-alone company," he says.

REVIVED AFTER A PLUNGE



Data: Bloomberg Financial Markets

The Buzzing About Honeywell

WITH ITS GLOBAL REACH in aerospace and industrial markets, Honeywell (HON) is a solid play on the economic recovery. So says Benjamin Segal of Winchester Capital, which has accumulated Honeywell shares, betting that its diversified operations, including power generation and industrial automation and control, will show robust growth. And its strong free cash flow—which he estimates at $1.8 billion in 2005, $2.3 billion in 2006, and $2.8 billion in 2007—should produce above-average growth, says Segal. Moreover, the stock is undervalued on a sum-of-the-parts basis, adds Segal, who estimates a combined worth at 58. The stock is now at 39, up from 35 in early May. Segal doesn't discount the possibility that Honeywell may get a fresh buyout bid. In 2000, General Electric topped a $[illegible] billion offer from United Technologies with its own $45 billion bid. But in 2001, the European Commission blocked GE from buying Honeywell. Nicholas Heymann of Prudential Equity Group rates the stock "overweight" with a 6-to-12-month target of 48. He sees profits of $2.20 a share in 2005 and $2.60 in 2006. Honeywell declined comment on buyout talk.

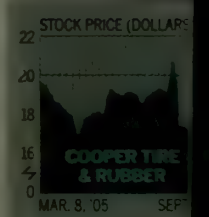
DARTING HERE AND THERE

Data: Bloomberg Financial M

Cooper Tire Could Really Make Tracks

THE STREET IS STEERING CLEAR of Cooper Tire & Rubber (CTB). Since the company posted a second-quarter loss, analysts have downgraded the stock and scaled back forecasts. Shares dropped from 20 on Aug. 1 to 16.70 on Sept. 14. A strike at Cooper's Texarkana (Ark.) plant brought a loss of 10¢ a share in the June quarter, vs. a profit of 45¢ a year ago. The jump in natural gas prices also jacked up production costs, and demand for replacement tires slowed. But Dave Young of Paragon Wealth Management is buying. "Cooper is a good contra-energy play," he says. Fears that oil will keep on rising and that tire demand will be soft are overblown, says Young. The stock has a favorable low-risk, high-reward profile, he notes. When the stock falls this low—close to its book value of over 17, it usually scores a big annual gain, says Young. It happened in 2001 and in 2003, when the stock nearly doubled. (Paragon's Top Flight Portfolio is up 300% since its start in 1998, vs. 42% for the Standard & Poor's 500-stock index.) He expects earnings in 2005 of 26¢ a share, down from 2004's $1.12. But he sees a rebound in 2006 to $1.01 and to $1.23 in 2007 because of an expected rise in demand, price hikes, and cost-cutting. His 12-month target: 23.

QUITE A SKID LATELY



Data: Bloomberg Financial M

Another bull is Saul Ludwig of Key Banc Capital Mar which has done business with Cooper. He rates it a buy.

BusinessWeek online Gene Marcial's Inside Wall Street is postec businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor t firms hold positions in the stocks under discussion. Similarly, they have no investi banking or other financial relationships with them.

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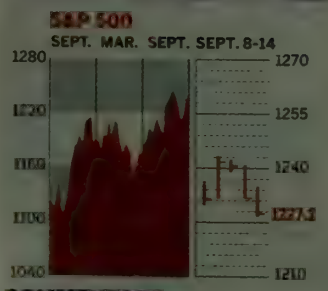
STOCKS



COMMENTARY

Stocks were little changed as traders tried to gauge the effects of Katrina on the economy and corporate earnings. But the markets were caught in a tight trading range even before Katrina as investors grappled with Fed hikes and soaring energy prices. And not even the pickup in mergers in such industries as banking and software lifted spirits on Wall Street.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	SEPT. 14	WEEK % CHANGE	YEAR TO DATE % CHANGE	LAST 12 MONTHS % CHANGE
S&P 500	1227.2	-0.7	1.3	[illegible]
Dow Jones Industrials	10,544.9	-0.8	-2.2	2.2
NASDAQ Composite	2149.3	-1.0	-1.2	12.2
S&P MidCap 400	712.6	-0.8	7.4	20.5
S&P SmallCap 600	347.9	-1.2	5.8	20.2
DJ Wilshire 5000	12,260.7	-0.8	2.6	11.5
SECTORS				
BusinessWeek 50*	741.1	-0.4	5.2	13.6
BW Info Tech 100**	367.9	-0.3	-1.4	10.4
S&P/BARRA Growth	586.2	-1.0	0.7	6.4
S&P/BARRA Value	636.7	-0.5	1.8	11.1
S&P Energy	391.4	1.0	35.6	47.0
S&P Financials	397.1	-0.5	-3.4	1.3
S&P REIT	154.6	-0.9	7.0	23.4
S&P Transportation	211.3	-1.5	-12.5	2.4
S&P Utilities	167.8	-0.2	18.5	[illegible]
GSTI Internet	175.5	-1.3	-1.6	18.0
PSE Technology	820.0	0.0	5.3	[illegible]

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	SEPT. 14	WEEK % CHANGE	YEAR TO DATE % CHANGE
S&P Euro Plus (U.S. Dollar)	1449.4	-1.3	3.7
London (FT-SE 100)	5347.4	-0.3	11.1
Paris (CAC 40)	4470.4	-0.4	17.0
Frankfurt (DAX)	4911.2	-1.5	15.4
Tokyo (NIKKEI 225)	12,834.3	1.8	11.7
Hong Kong (Hang Seng)	15,086.6	-0.9	6.0
Toronto (S&P/TSX Composite)	10,932.4	1.1	18.2
Mexico City (IPC)	15,221.4	-0.2	17.8

FUNDAMENTALS	SEPT. 13	WEEK AGO
S&P 500 Dividend Yield	2.03%	2.02%
S&P 500 P/E Ratio (Trailing 12 mos.)	19.3	19.3
S&P 500 P/E Ratio (Next 12 mos.)*	15.2	15.4
First Call Earnings Revision*	0.57%	0.80%

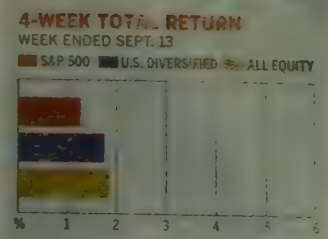
*First

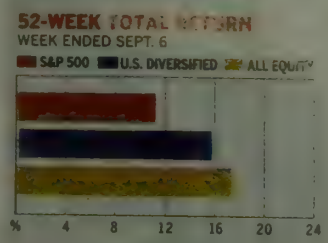
TECHNICAL INDICATORS	SEPT. 13	WEEK AGO
S&P 500 200-day average	1197.7	1196.3
Stocks above 200-day average	65.0%	67.0%
Options: Put/call ratio	0.69	0.83
Insiders: Vickers NYSE Sell/buy ratio	5.03	5.09

BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Instrumentation	20.1	Oil & Gas Refining	129.2
Oil & Gas Refining	17.4	Fertilizers & Ag. Chems.	77.4
Agricultural Products	8.7	Oil & Gas Exploration	73.7
Application Software	8.6	Oil & Gas Drilling	65.7
Insurance Brokers	8.0	Managed Health Care	64.4

WORST-PERFORMING GROUPS	LAST MONTH %	
Specialized Consumer Serv.	-13.0	IT Consulting
Specialty Appar. Retailers	-11.4	Automobiles
Aluminum	-10.7	Insurance Brokers
Home Furnishings Rtlrs.	-9.5	Internet Retailers
Computer Retailers	-8.9	Motorcycles

MUTUAL FUNDS





Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Latin America	5.6	Latin America	69.2
Japan	4.8	Natural Resources	52.1
Natural Resources	4.5	Diversified Emerg. Mkts.	39.9
Utilities	4.4	Utilities	33.0
LAGGARDS		**LAGGARDS**	
Financial	0.2	Financial	8.5
Pacific/Asia ex-Japan	0.3	Domestic Hybrid	9.6
Miscellaneous	0.5	Large-cap Blend	11.3
Domestic Hybrid	1.0	Large-cap Growth	12.2

[illegible]NDS

[illegible]	%	52-WEEK TOTAL RETURN	%
		LEADERS	
[illegible] Vl. A	15.0	Guinness Atkn. Gl. Energy	88.0
[illegible]	10.0	U.S. Glbl. Invs. Gl. Rscs.	80.0
[illegible]	10.0	BlackRock Gl. Res. Inv. A	76.9
Winslow Green Growth	8.8	T. Rowe Price Lat. Am.	75.6
		LAGGARDS	
Potomac [illegible]	-5.6	Ameritor Investment	-56.0
[illegible]	-5.4	ProFds. USh. Mid Cap Inv.	-32.6
iShares FTSE [illegible]	-5.2	ProFds. USh. Sm. Cap Inv.	-31.0
Rydex Dyn. [illegible]	-3.7	Potomac Sm. Cap/Sh. Inv.	-23.1

INTEREST RATES

KEY RATES	SEPT. 14	WEEK AGO	YE
Money Market Funds	3.03%	3.07%	1
90-Day Treasury Bills	3.43	3.48	[illegible]
2-Year Treasury Notes	3.88	3.85	2
10-Year Treasury Notes	4.17	4.14	[illegible]
30-Year Treasury Bonds	4.45	4.42	[illegible]
30-Year Fixed Mortgage†	5.66	5.65	[illegible]

†BankRate

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR BOND	30-YR [illegible]
General Obligations	3.59%	[illegible]
Taxable Equivalent	5.13	[illegible]
Insured Revenue Bonds	3.77	[illegible]
Taxable Equivalent	5.39	[illegible]

THE WEEK AHEAD

RESIDENTIAL CONSTRUCTION *Tuesday, Sept. 20, 8:30 a.m. EDT* » Housing starts in August very likely eased to an annual pace of 2 million. That's the median estimate from economists surveyed by Action Economics. In July, starts slipped to 2.04 million.

FOMC MEETING *Tuesday, Sept. 20, 9 a.m. EDT* » The Federal Reserve's Open Market Committee meets to set monetary policy. The central bank is still expected to raise the Fed funds rate by a quarter point, to 3.75%. But in light of Hurricane Katrina, the number of economists forecasting a rate hike has fallen. There is also a growing view that the Fed will pause after another rate increase in November.

INITIAL UNEMPLOYMENT CLAIMS *Thursday, Sept. 22, 8:30 a.m. EDT* » New filings for state unemployment insurance claims probably jumped to 350,000 in the week ending Sept. 17, from 319,000 for the week ended on Sept. 2. A wild card is the timing of claims filed from persons displaced by Katrina.

LEADING INDICATORS *Thursday, Sept. 22, 10 a.m. EDT* » The Conference Board's August index of leading economic indicators probably fell 0.1%, following a 0.1% rise. Dips in weekly factory hours, consumer sentiment, and stock prices will weigh on the index.

The *BusinessWeek* production i[illegible] moved up to 253.9 for the [illegible] ended Sept. 3, an 11.8% gain fr[illegible] year ago. Before calculation o[illegible] four-week moving average, the i[illegible] held steady at 254.5.

BusinessWeek on[illegible]

For the BW50, more investme[illegible] data, and the components of the production index visit www.businessweek.com/extras

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The Companies

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

A

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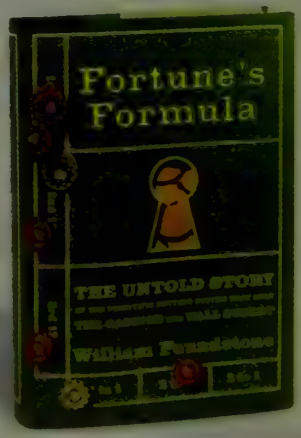
Get Rich: Here's the Math

FORTUNE'S FORMULA The Untold Story of the Scientific Betting System That Beat the Casinos and Wall Street
By William Poundstone; Hill and Wang; 386pp; $27

In July, 1956, the august *Bell System Technical Journal* published one of the oddest articles in the history of communications research—an equation-filled treatise on how to make money at the racetrack if you have inside information on which horse is likely to win. Betraying no sense of incongruity, the article, by a young Texan physicist named John L. Kelly Jr., prescribed how much of your bankroll to bet based on two things: how certain you are of betting right (your "edge") and your winnings if you are right (the odds).

Fortune's Formula, by William Poundstone, is the sometimes-deep, sometimes-Runyonesque tale of the Kelly system's origins in research at Bell Laboratories and how people have used it to make money since. Although Kelly wrote about the horses, his approach is at least as useful on Wall Street. Legg Mason Capital Management CEO Bill Miller, among the most consistently successful investors of recent decades, wrote two years ago that "the Kelly criterion is integral to the way we manage money."



Parts of this amazing story have been told before. Edward O. Thorp, a gambling mathematician who co-founded the successful hedge firm Princeton Newport Partners, popularized the Kelly criterion in the 1960s with two books, *Beat the Dealer* and *Beat the Market*. Today, gamblers talk of using "Kelly" or "half-Kelly" when placing their bets.

But no one has ever told the whole colorful, sprawling tale until Poundstone. *Fortune's Formula* stretches from 18th century St. Petersburg, Russia, to the present-day U.S. and features characters ranging from such lowlifes as mobsters Al Capone and Longy Zwillman to intellectual giants like Paul Samuelson. The economist was so irritated by the Kelly approach that in 1979 he wrote a scholarly article against it, mocking his opponents' intelligence by using only one-syllable words.

Fortune's Formula will appeal to readers of such books as Peter L. Bernstein's *Against the Gods*, Nassim Nicholas Taleb's *Fooled by Randomness*, and Roger Lowenstein's *When Genius Failed*. All try to explain why smart people take stupid risks. Poundstone goes them one better by showing how hedge fund Long-Term Capital Management, for one, could have avoided disaster by following the Kelly method.

What is the Kelly criterion? It's a system that tells you how much of your money to bet to maximize the growth rate of your wealth—while controlling risk. Technically speaking, it says the fraction of your payroll that you bet should equal your edge divided by the odds. Although Poundstone is a good explainer, the details can be heavy going for casual readers. Here's an example from the book that, for the purpose of simplicity, omits the track's take: The tote-board odds for Secretariat are 5 to 1, so a winning $100 bet pays $600. But you have a tip that Secretariat actually has a 1 in chance of winning, so you have a one-third chance (instead one-fifth) of winning $600. Dividing $600 by 3 gives you a weighted average payout of $200. Subtracting your bet leav you with a profit of $100. The edge is defined as the profit divided by the wager, namely $100 divided by $100, or 1. T odds are defined as 5 to 1, or simply 5. So edge/odds equals 1/5, meaning you should bet one-fifth of your bankroll on Secretariat. That's it.

In his 1956 paper, Kelly demonstrated that a gambler with an edge who reinvested all profits would earn more money in the long run with his strategy than any other and could never go broke (because no bet is ever as big as the bankroll exc for sure winners). This grew out of the work of th genius Claude Shannon, a Bell Labs colleague w pioneered information theory. Shannon showed that the more certainty there is about the accurac of information received, the higher a communication circuit's capacity ("R"). For Kell the more certain the tips, the higher the growth r of the gambler's stake ("G"). Kelly connected his work and Shannon's succinctly: $G_{max}=R$. Poundstone says this equation "is as beautifully daring as $E=mc^2$."

Fifty years on, this gambling strategy is still in use at racetracks and hedge funds

Kelly died of a brain hemorrhage on a Manhattan sidewalk at age 41, in 1965, apparently never having used his own criterion to make money. Economists are still divided over his legacy. Critic say the Kelly criterion's retur are too volatile for many peop and it doesn't work unless yo reinvest all profits.

But Kelly's invention remains both useful and fascinating. It's possible to "tame" the system's swings by making bets half the recommended size ("half Kelly"). Anyway, the Kelly criterion is just kind of cool. Poundston says that to a limited extent, it "has entered the company pi and the golden section as one of those rare mathematic ideas that captures the imagination of nonmathematician That's a bit much. Still, Poundstone deserves credit for giving this big idea the star treatment it deserves. ■

– By Peter

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IdeasViewpoint

BY LAURA D'ANDREA TYSON

Land of Unequal Opportunity

Just days before Hurricane Katrina devastated New Orleans, the U.S. Census Bureau published its annual report on income in America. The poverty rate increased in 2004 for the fourth year in a row, and 37 million Americans (12.7% of the population) were living in poverty—4 million more than in 2001, despite three years of economic recovery. Sadly, more than 15 million of these impoverished Americans, many of them children, lived in households headed by full-time workers.

Not surprisingly, the Census results received scant media coverage. After all, it's certainly not news that many very poor people (often people of color) live in the richest nation on earth. Besides, mind-numbing statistics can't portray what a life of poverty means, anyway. But what the Census report could not convey, the pictures from flood-ravaged New Orleans did in graphic and heartrending ways.

Those scenes confirmed the inescapable conclusion of recent series in *The New York Times*, *The Wall Street Journal*, and the *Los Angeles Times*: Class, defined by economic and social status and often linked with race, largely determines how one fares in modern America. This nation may be based on egalitarian principles enshrined in the Declaration of Independence, but an individual's access to educational opportunities, health care, transportation, decent housing, and even disaster relief services depends on income and class.

INCOME IS A MAJOR DETERMINANT of health and longevity in the U.S. Poor Americans are less apt to have health insurance, more apt to have untreated medical conditions, and much more likely to have and die of heart disease, diabetes, or cancer. Infant mortality is higher and longevity rates are lower in some of America's inner-city neighborhoods than in many developing countries—not because of crime and drug abuse, but because of lack of adequate medical care.

Moreover, poverty, as distinct from such factors as family structure, race, and parental education, has a significant adverse effect on educational achievement. Poor children are more likely than children from middle- and upper-income households to drop out of high school, less likely to enroll in college, and less likely to graduate if they enroll. And income and racial disparities in educational attainment are growing at a time when a college education is becoming a necessity for obtaining a job that can support a middle-class life. If these trends continue, more and more children born into poverty will remain poor, and economic mobility will continue its downward trend.

Katrina revealed other disturbing aspects of what it means to be poor in America. The majority of those trapped in New Orleans could not escape because they had no car, no cash reserves for the proverbial rainy day, and no financially secure extended family to turn to for help—all common problems of America's poor. Like most Americans, they thought they could turn to the government to supply their immediate needs in the wake of a natural disaster. They were wrong.

Are President George W. Bush and his Republican allies in Congress concerned about the growing income, class, and race cleavages exposed by Katrina? Even after the hurricane killed estimated hundreds of impoverished Americans and sent tens of thousands more into unemployment, homelessness, and despair, Republican leaders remain firm in their support of permanent repeal of the estate tax. The big beneficiaries would be the very rich—the top 1% of the income distribution who receive more pretax income than the bottom 40% combined, who own more household wealth than the bottom 90% combined, and who pay two-thirds of the estate levy. Estate tax repeal would reduce government revenues by an estimated $745 billion over 10 years. The forgone revenues would be more than enough to cover the costs of relief and reconstruction after Katrina and to increase funding for programs for those of modest means such as Medicaid, Head Start, and Pell grants for college.

> New Orleans graphically showed what the Census report could not convey

Even the greatest natural disaster in the nation's history may not be enough to change the Republican leadership's budgetary priorities: slashing taxes for the rich, cutting spending on the poor, and underinvesting in services like emergency response or flood control in Louisiana. But perhaps American voters, dismayed by what they have learned about income and race in America in Katrina's aftermath, will want a change. According to surveys, most Americans value a "fair" society defined as one in which "no one is left behind." Scenes from New Orleans reveal this is definitely not the society in which they live today. ■

Laura D'Andrea Tyson *is dean of London Business School (ltyson@london.edu)*

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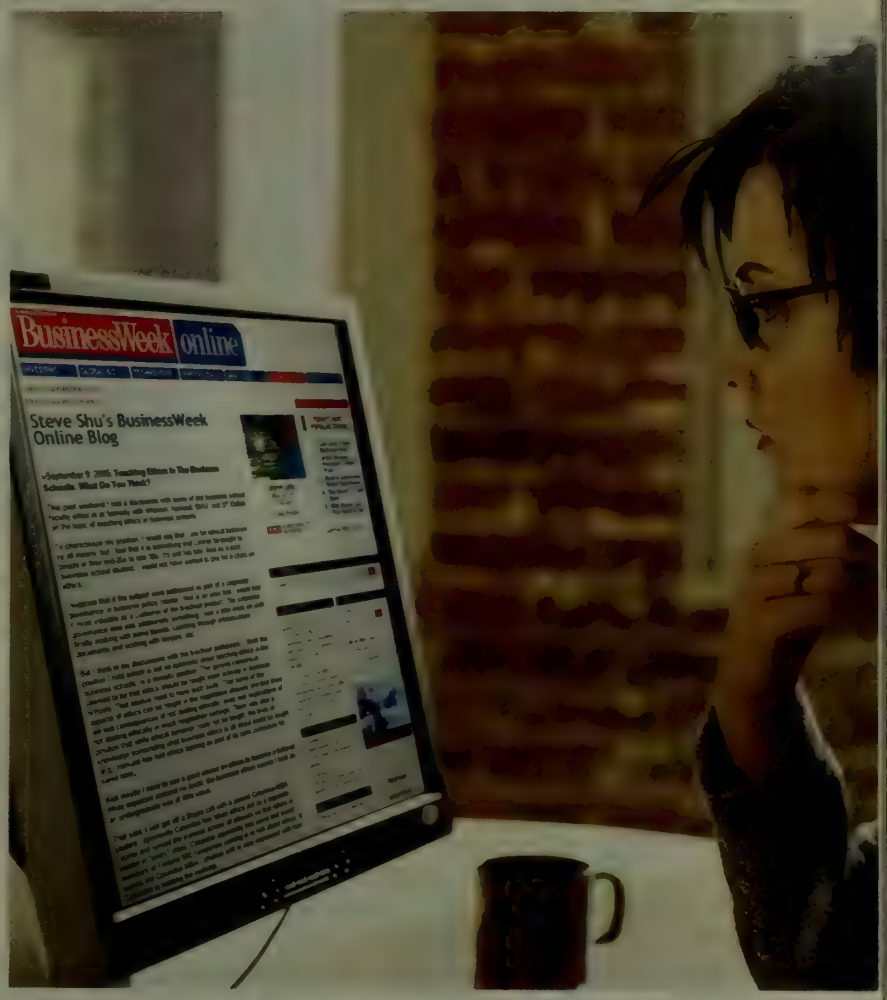

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Katrina: Help People, Not Places

WHENEVER NATURAL disasters like hurricanes, tornadoes, earthquakes, or floods strike America's shores, the engine of government normally chugs into motion with one goal in mind: rebuilding. And already politicians, economists, and urban planners are hard at work debating the face and shape of the "new" New Orleans that officials vow will rise from Hurricane Katrina's wreckage. But just as Katrina wasn't your typical disaster—more than 330,000 families have been displaced, and the costs from damage and rebuilding could exceed $100 billion—neither should planning for its recovery be in the usual mold.

Indeed, rather than merely reconstructing the physical property that defined the Gulf Coast before the storm, government must also funnel long-term aid to the new locales where Katrina refugees may choose to stake their futures. That means directing dollars far from the storm center in coastal Louisiana, Mississippi, and Alabama, or even refugee havens like Texas. The real mission, as Harvard University economist Edward L. Glaeser puts it: Help people, not places.

That's tricky, given the natural inclination to concentrate reconstruction efforts on the New Orleans area after the initial inadequate response to survivors trapped there. But that would be a mistake. No one knows exactly what a revived New Orleans will look like, but it's almost certain the city will be a smaller, more focused metropolis with fewer residents in the poorer, low-lying parishes that suffered some of the worst flooding. So there may not be room for everyone to come back anytime soon, even if they want to.

Aid should assist the displaced in relocating where they wish

Besides, the unusually high concentration of the poor in New Orleans—almost a quarter of its residents had family incomes below federal poverty guidelines—means that simply rebuilding their former homes would still leave a huge local underclass. If better job prospects, living conditions, and local schools are available in the new communities where displaced residents have landed, then federal housing assistance and emergency aid to local school districts should be used to help the displaced permanently relocate where they wish.

Wisely, the federal government has already designated 38 states as Katrina-related emergency sites—including faraway states such as Montana and Massachusetts—making them eligible for financial assistance to provide emergency services to temporary refugees who may actually become permanent residents. And with the Federal Emergency Management Agency acknowledging that displaced families are currentl residing in all 50 of the nation's states, it will probably nee cast its aid net even wider.

None of this downplays the need to rebuild the Gulf Coa region. But many displaced residents are likely not to retur Indeed, the U.S. has often experienced population shifts in times of stress or social change. Whether during the Dust Bowl exodus from the Great Plains during the 1930s, the massive post-World War II population shift to California, o the Great Migration of millions of Southern blacks to the North and West between 1920 and 1970, Americans have always moved in search of a better life. Government shoulc give those displaced by Katrina that same opportunity.

A Wide-Open Window in Japan

SOMETHING QUITE extraordinary has jus transpired in Japan. On Sept. 11, Prime Minister Junichiro Koizumi engineered o of the most stunning electoral victories i Japanese postwar history by effectively trash-talking his own long-dominant Liberal Democratic Party. Throughout the campaign, his constant targets were the LDP stalwarts who for years tolerated and prospered from the corrupt, insider-driven machine politics that long had been the party's distinguishing feature. The contest drew a record voter turnout and has left an LDP claiming to be committed to reform under Koizumi's leadership with an absolute major in the Japanese Diet.

Rarely has a call for financial reform received such a ringing political acclamation. Koizumi called the election i early August when anti-reform elements inside the LDP, lo supported by postal unions, blocked his efforts to privatize Japan's $3 trillion postal savings system. It was risky, but Koizumi deftly used the media to explain to voters what w at stake: By moving the nation's postal savings stash into t private sector, the LDP would no longer have a fat piggy ba to fund pork barrel projects to buy off voting blocs.

The massive rally in the Nikkei in recent weeks and a ste stream of robust economic data suggest Koizumi's moves t clean up the banking sector, turn off the public works spigo and hand out Cabinet posts based on merit rather than connections are finally paying off. Now Koizumi should quickly use some of his enormous store of political capital t begin taming Japan's giant budget deficits, introduce regulatory reforms and more state asset sales to bolster the country's still-lagging economic competitiveness, and shor up its insolvent state-run pension system before his schedu resignation in September, 2006. Landslides are a rarity in Japan, so Koizumi must make the most of this one.

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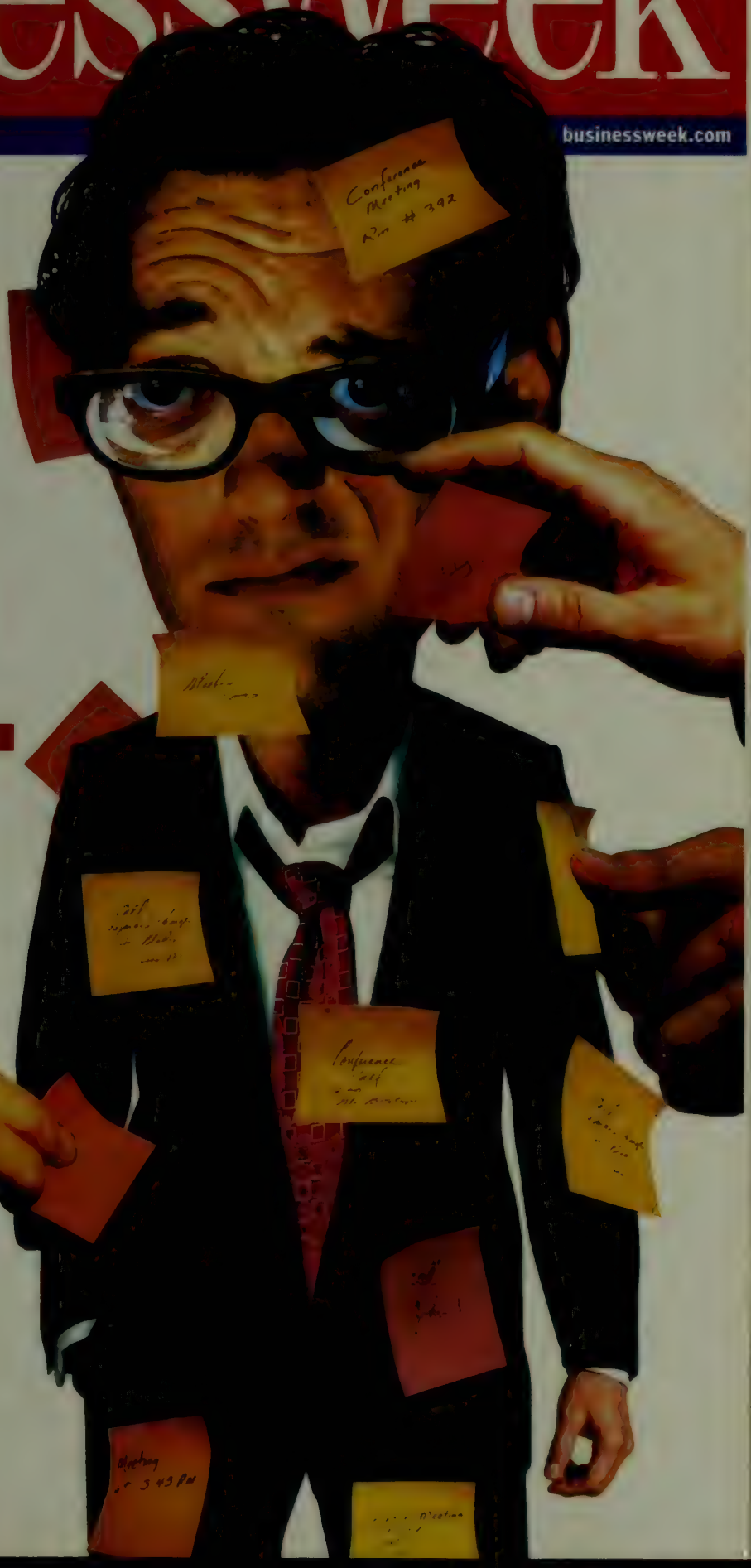
MICHAEL MANDEL (P. 60)



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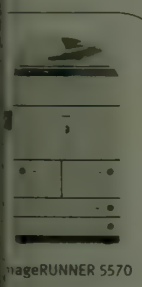

mageRUNNER 5570

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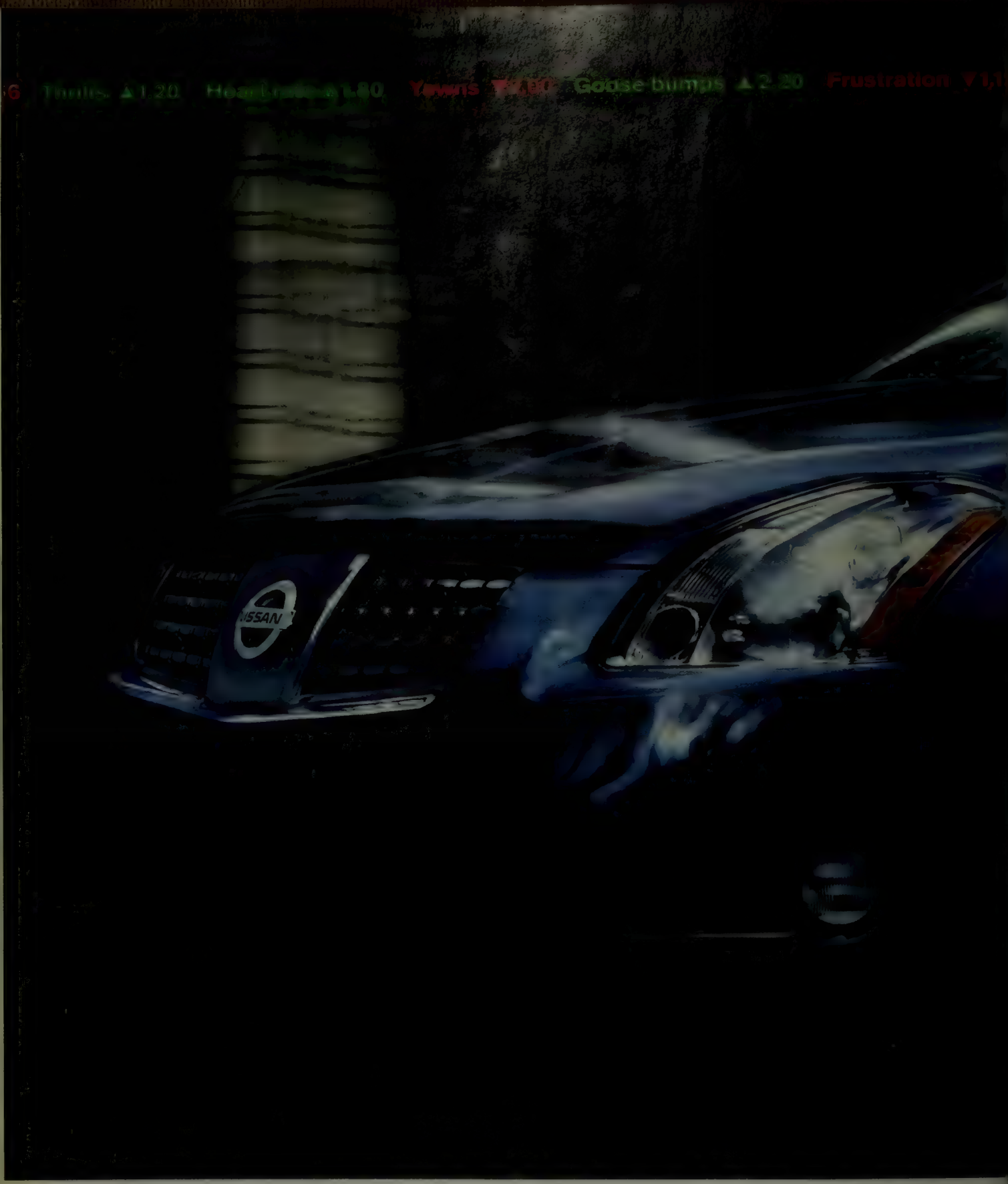

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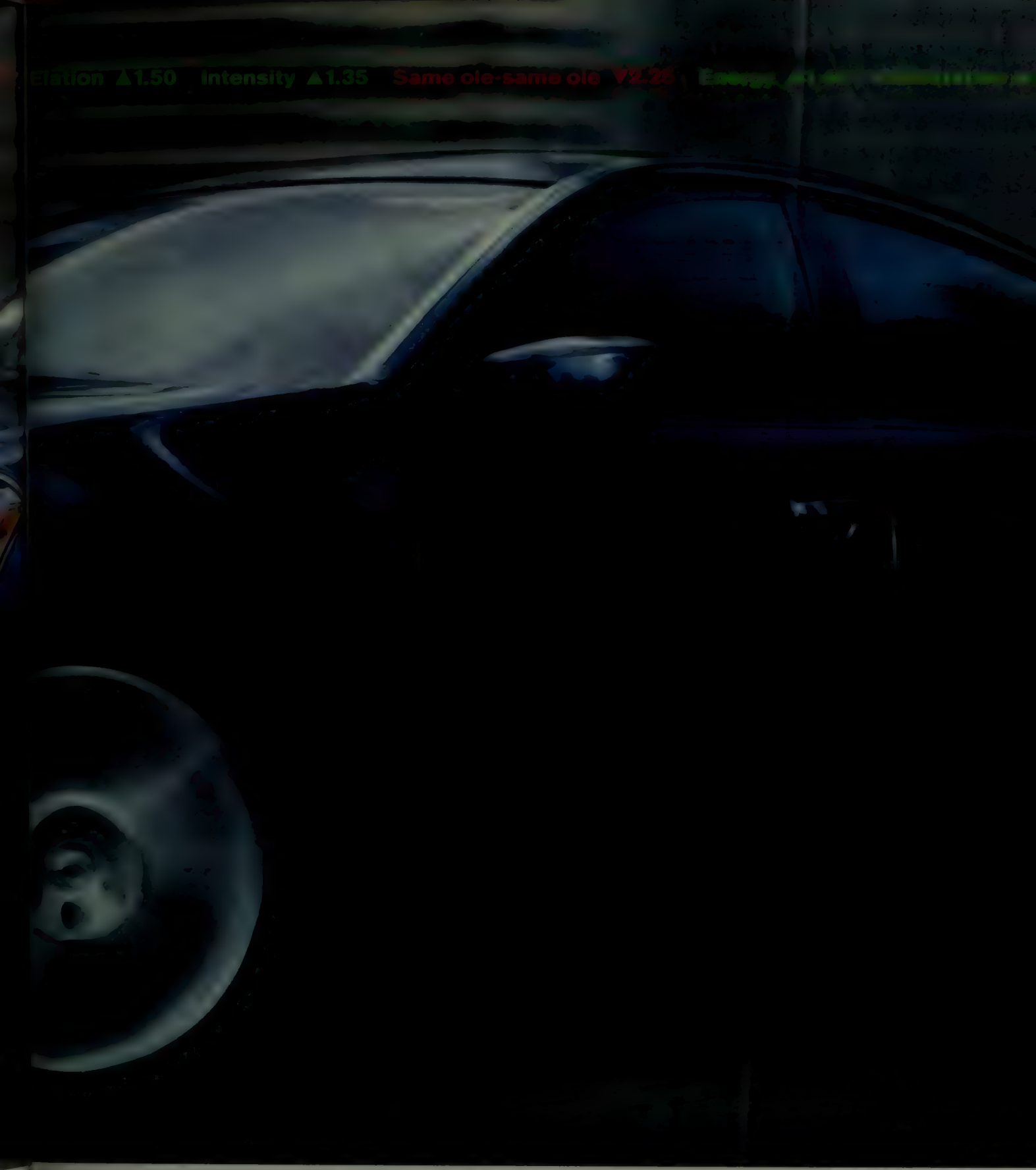

The 265-hp Nissan Maxima

NISSAN

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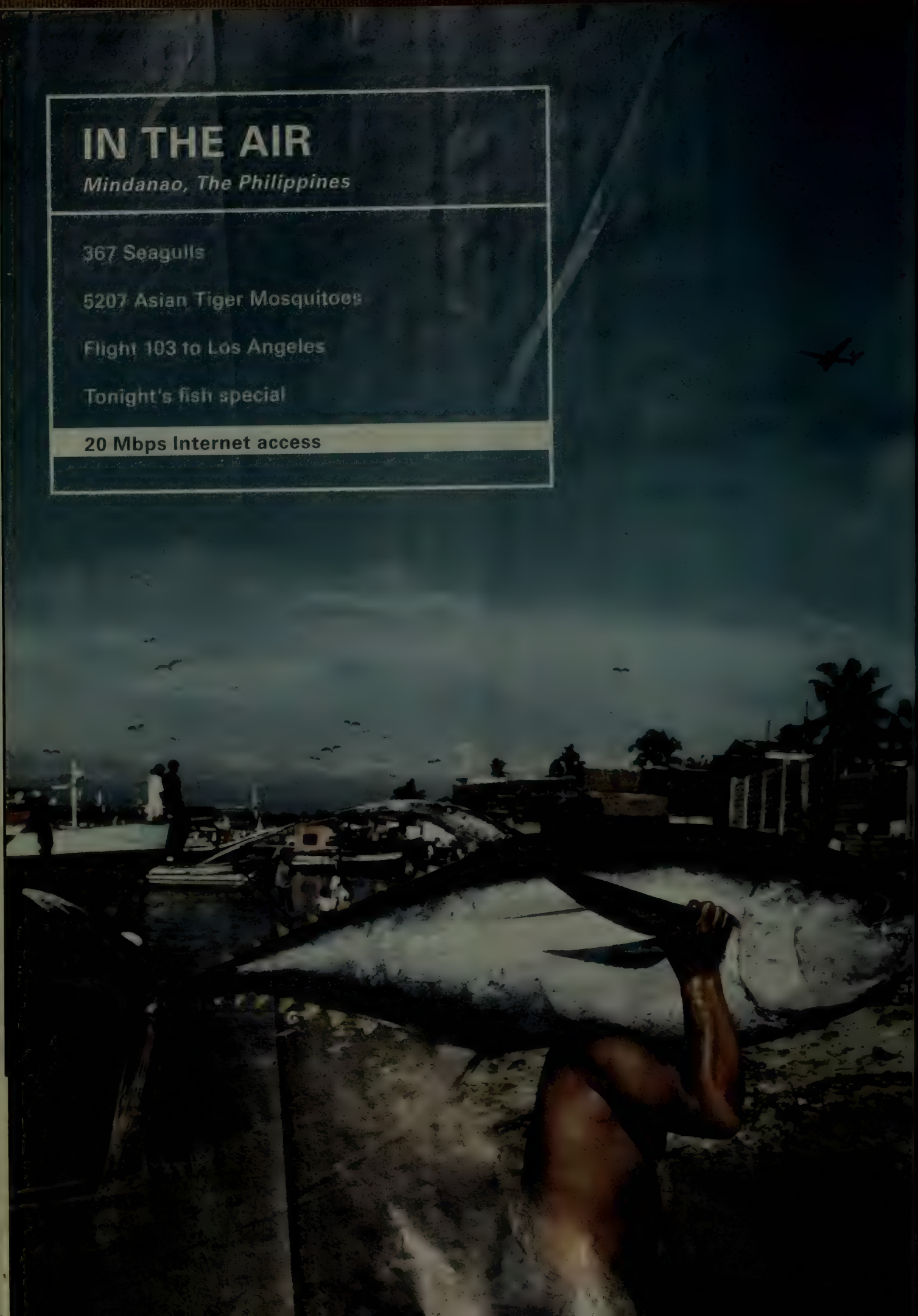
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October 3, 2005

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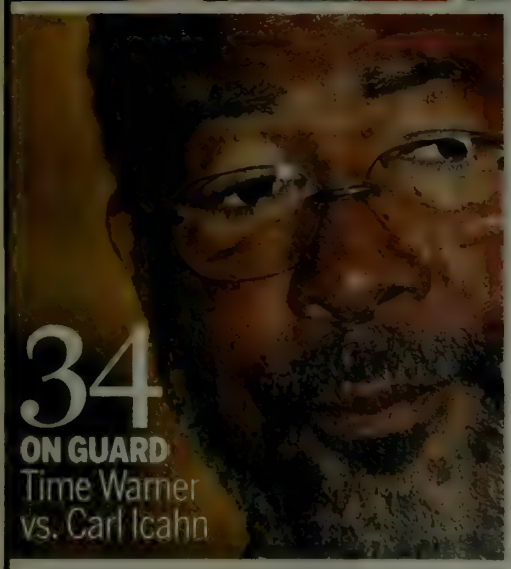

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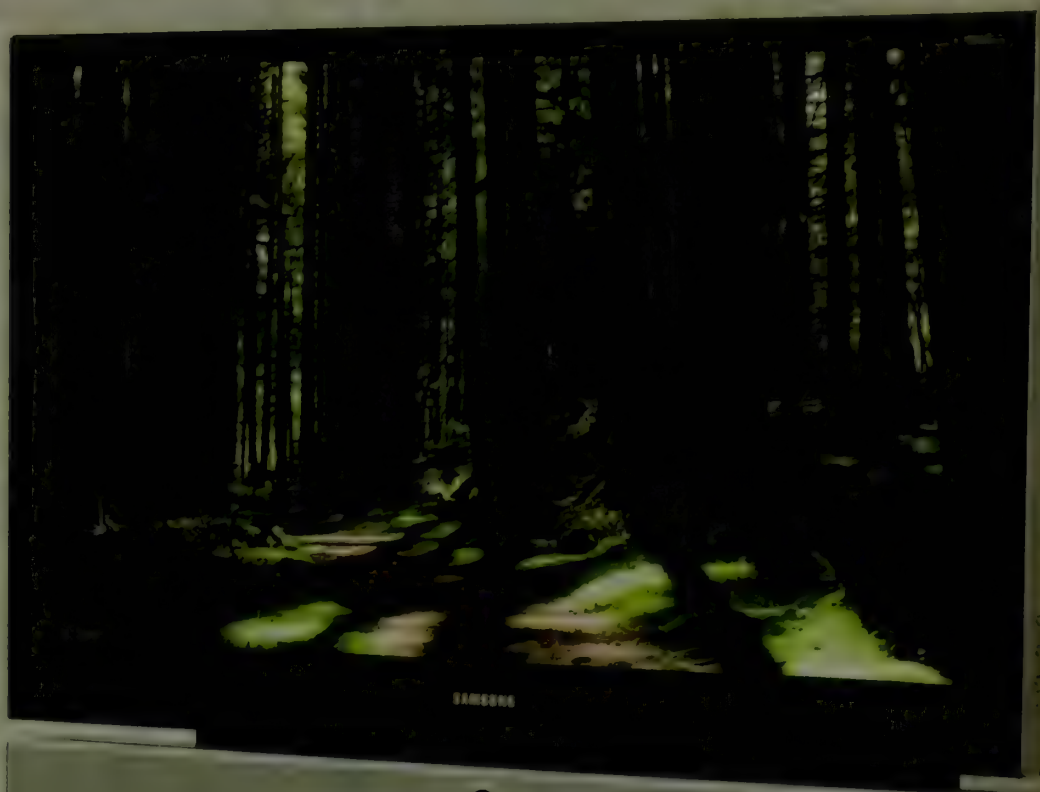

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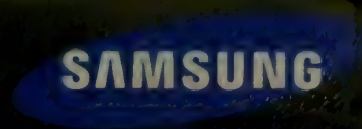

"HENDRICK'S WON THE GIN CATEGORY"..

- *THE WALL STREET JOURNAL*

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FRIDAY, AUGUST 29, 2003 – VOL. CCXLII NO. 43 – ★★★★ $1.00

When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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TOP 3 GINS	
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Tanqueray No. Ten $26/750ml	Smoothest
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Special Report: A Low-Cost Energy Future

That dream is still a way off, but thanks to a confluence of events, from raging storms to terrorism to basic oil economics, conservation and alternative energy are back in the spotlight. These stories examine the progress and find a slew of notable trends: **Homes** that create as much energy as they consume, the rise of more fuel-efficient **autos,** even renewable power sources that serve **individuals' needs** (charge your cell phone with your solar purse). Plus: Simple tips for saving energy today

Your Air Taxi Is Almost Ready For Takeoff

Boston's Linear Air is out to get a jump in this new form of point-to-point flying. While competitors wait for the arrival of new "very light jets," the startup is building a customer base using existing aircraft

Startup Stars, Eager for An Encore

At this year's DEMOfall conference devoted to innovative new products and services from startups, several tech veterans will be out to strike gold for a second or third time

Will It Be Hybrids or Diesels? Probably Both

To compete in the fuel-hungry global market, carmakers are realizing they can no longer offer consumers just one alternative to gasoline engines

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_THE INVASION

_DAY 10: I'm...losing...my...mind. Too many servers. Too many operating systems. Too many databases. Nothing's integrated. Aaaiigh.

_DAY 39: They've invaded the snack room. I thought I'd gone insane, but Dwayne sees them, too.

_DAY 40: I have taken control with an iSeries system. It's a single integrated solution — server, storage, software and security — that runs multiple operating systems. Now, everything's simple. Booyah!

_DAY 41: I wonder how many other I.T. guys are out there, trapped by their own infrastructure? ...Oh, the humanity.

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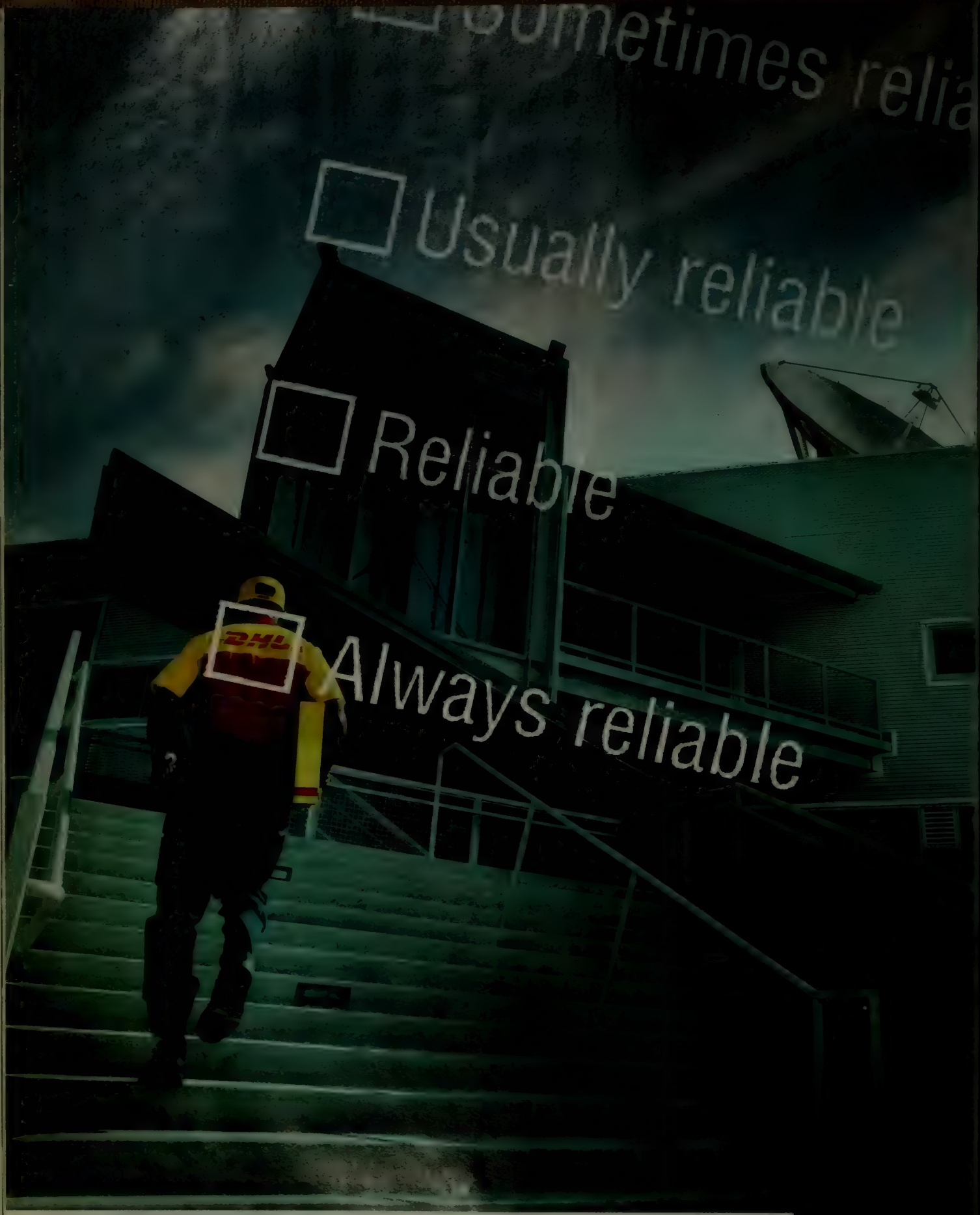

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UPFront

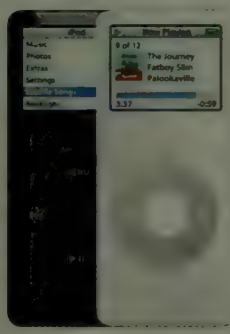
"It's really only the size of a very large house."

–Larry Ellison, Oracle CEO, on his 454-foot yacht, the world's longest privately owned boat, to Vanity Fair

EDITED BY DAN BEUCKE

PRODUCT PEEK

THE iPOD NANO UNDER A MICROSCOPE



AS WITH A Hollywood *roman à clef*, the buzz around **Apple's** new iPod Nano music player has shifted to "Who's in it?" Researcher **iSuppli** tore apart a Nano to figure out what makers provide its parts. One big loser was **Synaptics**, supplier of touch-sensitive chips that are key to the original iPod's click wheel. In the Nano, Synaptics was nudged aside by an Apple-designed wheel using chips from **Cypress Semiconductor**. A winner: **PortalPlayer**, whose audio chips were in hard-drive based iPods but dropped in Apple's first flash memory player, the iPod Shuffle. A specially made PortalPlayer chip made it into the Nano.

Few who purchase a 2-gigabyte Nano (retail price: $199) will be shocked that, according to iSuppli's Chris Crotty, it has a 50% gross profit margin before marketing, distribution, and other costs. Crotty pegs the cost of parts at $90.18, plus $8 for assembly. Apple got a 40% break on flash memory from **Samsung**, he says. That price will challenge rivals. But it could also give them supply headaches: Apple agreed to buy 40% of Samsung's flash-chip output. *–Arik Hesseldahl*

THE BIG PICTURE

RUNNING ON FUMES Sales of big SUVs fell 29% in August as drivers reacted to rising gas prices. Among the biggest losers:

Ford Expedition	–40%
Hummer H2	–38%
Chevrolet Tahoe	–34%
GMC Yukon	–30%
Toyota Sequoia	–29%

Change in sales August 2005, vs August 2004 — Data: Autodata Corp

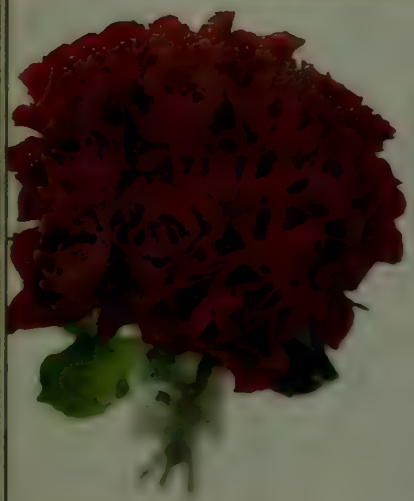
PIPE DREAM

Virgin in The Oil Patch

RICHARD BRANSON SEEMS less angry about oil prices than envious. Sensing massive oil-industry profits for years to come, the maverick founder of Britain's **Virgin Group** wants to get into the business himself. First up: an oil exploration company that will probably have an African chief executive and begin scouting in a matter of months. But the real stretch is a $2 billion oil refinery that he hopes to have running, probably in Europe or Africa, within four years. While Branson is trying to woo partners by throwing in $100 million of his own money—and maybe more—he admits he's entering a field where the Virgin brand won't generate much buzz. "The goal is obviously to make money," he says, "and it's quite a good hedge against rising [jet] fuel prices."

Branson figures that if prices collapse, his various airlines will benefit from lower fuel costs. That's why he's targeting other energy-dependent users as investors. But he probably won't have much luck with cash-strapped U.S. carriers. And oil experts say the high profitability of refining may well be temporary. "With the exception of the past few years, oil refining has been an industry that people have tried to get out of," says Ronald Gold, vice-president at the **Petroleum Industry Research Foundation**. "It's not a totally ridiculous idea, but he's coming in near the top." *–Diane Brady*

UPFront



WEB WATCH

FORGET-ME-NOTS OUR SPECIALTY

FOR THE BUSY professional who needs help remembering the little things, there's a new flower-delivery service: **SaveMyAss.com**. Unveiled on Sept. 9, it sets up a schedule that can include birthdays, anniversaries, and "random" deliveries every four to six weeks. So that customers aren't caught off guard by their own acts of kindness ("you are definitely kept in the loop," the Web site assures), SaveMyAss fires off an e-mail reminder to senders before delivering a vase of long-stemmed roses or a bouquet of lilies and larkspurs to loved ones.

The venture is the latest brainchild of two cheeky entrepreneurs—Al Lieb, the co-founder of invitation site **Evite**, and James Hong, the co-founder of online dating site **HotorNot.com**. "Guys—even when they're well intentioned—need a little nudge," Hong says. Customers are charged a $5 commission on orders ranging from $59 to $125. And if all else fails? There's a Panic Button feature, which helps gauge what kind of flowers to send with prompts such as "She's throwing things." *–Heather Green*

A HAIL OF A DENT

HEADING OFF STORMS Everybody gripes about the weather, but Nissan is doing something about it. Nissan uses "hail-suppression cannons" to minimize damage to cars outside its Canton (Miss.) plant, where as many as 6,000 vehicles often await shipment. The cannons emit sonic shock waves up to 20,000 feet—in theory, scattering water drops before they can freeze. Some experts question whethe it works. But Nissan says the number of storms dropped after it started using the 20-foot cannons in late 2003. Nissan contends the 50-decibel blasts are "no louder than highway noise." But after neighbors beefed, the compar agreed to shorten their firing time. *–Dean Fou*

AFTER KATRINA

TOO TAINTED TO HANDLE RELIEF FUNDS?

HUEY LONG would be appalled. Representative Tom Tancredo (R-Colo.) has proposed keeping billions of hurricane recovery money away from corrupt Louisiana and New Orleans politicians. On Sept. 7, Tancredo wrote to House Speaker J. Dennis Hastert (R-Ill.), pointing to a long list of convicted state officials: "I am not confident that Louisiana officials can be trusted to administer federal relief aid." The difficulty of rebuilding without local politicians, and the negative response of state congressional delegates, will probably ensure this idea is dead. *–Eamon Javers*

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FACE TIME

RICHARD SHOEMAKER

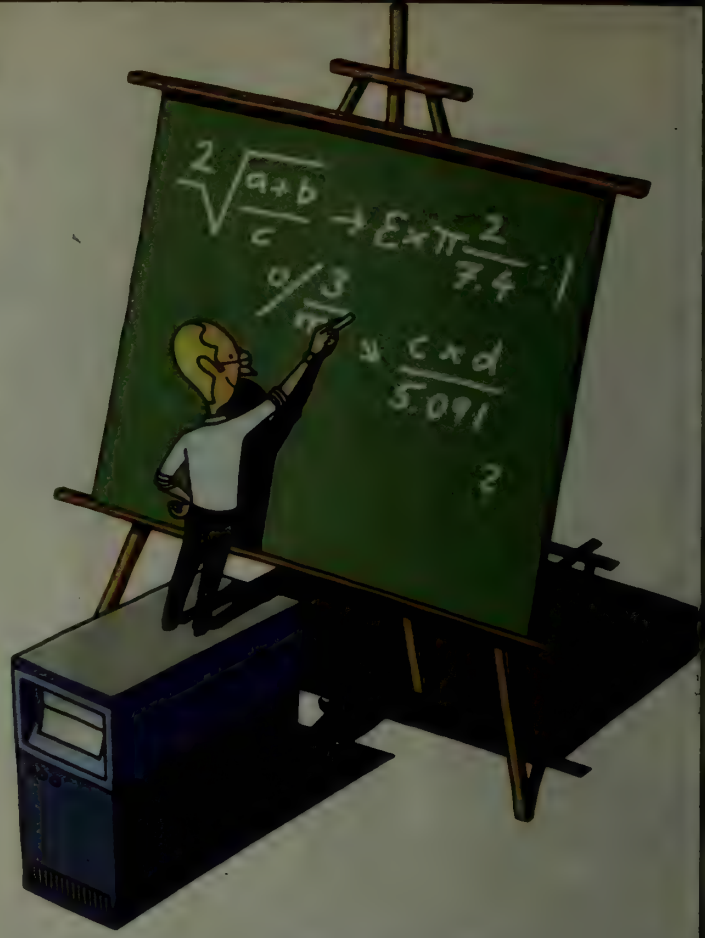
THE UAW'S THORNY PATH AT GM

Richard Shoemaker speaks so softly that you may have to lean in to hear him. But as head of the United Auto Workers' General Motors Dept., he wields a big contract. A Missouri native who at 18 followed his father into a job at John Deere, Shoemaker hit the limelight in 1998 as chief negotiator during a 54-day strike that cost GM $2 billion. Today, GM's situation is worse. Yet Shoemaker, 65, bristles at suggestions that workers should slash their health benefits to help out. The problem, he says, is GM's falling market share: "Whether you're selling cars or peanuts, if you sell less of them, you get less revenue."

The UAW is stuck, though, too. Shoemaker also deals with auto-parts maker Delphi, which may file for bankruptcy without $2.5 billion in givebacks. But Shoemaker says he is fighting something bigger: the loss of U.S. jobs to cut-rate markets: "This country is a beacon for people around the world. They come here because they want to do better." *–Kathleen Kerwin*

TEACHING NOTES

FROM IBM TO SCIENCE AND MATH CLASSES

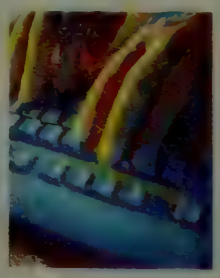


TECH COMPANIES have long bemoaned the shortage of U.S. math and science teachers. Now, **IBM** hopes to encourage some veteran employees to step into the breach. On Sept. 16, Big Blue said it would help selected workers become certified teachers. Employees with 10 years of experience and a math or science degree will be able to take certification courses while still working for IBM. They will take a leave to complete up to three months of student teaching. And IBM will give each of them up to $15,000 to cover course costs and missed salary. Finally, it will help place departing workers in teaching jobs.

Most participants are likely to be in their early-to-mid-50s, when many retire from IBM and are interested in launching a second career. They'll take a pay cut to teach, although an IBM pension and other retirement savings will help ease the blow for some participants. But education officials, such as Joel Klein, chancellor of **New York City Public Schools,** are ready to welcome them with open arms. Just 100 IBM employees, mostly from New York and North Carolina, will take part in the program. If it works well, "our intention i to expand," says Stanley Litow, vice-president for IB Corporate Community Rela tions. That could mean hun reds of teachers from IBM's 160,000 U.S. workers. IBM obviously can't plug the sho tage of 250,000 math and science teachers by itself. B officials hope its example w persuade other outfits to follow suit. *–William Symon*

PC PATROL

IS SOMEONE LISTENING TO YOUR TYPING?



RESEARCHERS AT the **University of California at Berkeley** found that eavesdroppers with a few algorithms can read your typing just by listening. Computer science professor Doug Tygar and PhD students Li Zhuang and Feng Zhou made 10-minute recordings of subjects typing on PCs. They used speech-recognition technology to categorize and "read" the taps. This works because each key makes a distinctive sound when it strikes the metal plate below most keyboards. "It's like hitting a drum," says Tygar.

Eavesdroppers presumably would bug your office or aim a microphone at a window. Tygar's team, funded by the **National Science Foundation,** has yet to find anyone using the technique. But he is fielding calls for keyboards that would generate random typing sounds. Silicon Valley, are you listening? *–Elizabeth Woyke*

THE STAT

6.2

The number of U.S. households, in millions, that are expected to cut the cord on their telephone land lines this year and becom completely wireless.

Data: Yankee Group

ery new Sonata passes through a 360-degree rotary-dip paint primer bath, not once but 11 times.

360° approach to quality. At Hyundai, we're obsessed with the process of quality. or example, the body of the all-new Sonata rotates through the paint primer ath 11 times. What's more, the primer is electrically charged so that paint is ttracted to even the most remote parts. The result is a vehicle with a new evel of corrosion protection and a flawless paint finish. The rotary-dip bath is ust one of the new, cutting-edge, environmentally friendly processes at our tate-of-the-art assembly plant in Montgomery, Alabama. Where we lead the way n advanced manufacturing technology. It's a Hyundai like you've never seen before.

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"Most Americans did not need Katrina to teach them how current U.S. policies are putting the future at risk."

–Aaron Gerwitz
Ramstein-Miesenbach, Germany

HARSH LESSONS FROM A HURRICANE

"KATRINA'S WAKE" (Cover Story, Sept. 12) did a good job highlighting the costs of America's irresponsibility in managing its natural resources. Now, sadly, we suffer again opportunistic, shameless race-baiting and unstatesmanlike political sniping from some, when all should be pulling together. The sophomoric blame game and finger-pointing is unhelpful. Americans should appreciate two follies borne out by Katrina: disrupting Mother Nature; and electing or appointing government officials who are not honorable, capable, and strong leaders. We now must pay the price for such folly.

–Colonel Harold B. Wilber (Ret.)
U.S. Marine Corps
High Springs, Fla.

A NUMBER of suggestions for public policy in "Let that be a warning" are clearly worthy of strong consideration (Cover Story, Sept. 12). Most Americans did not need Katrina to teach them how current U.S. policies are putting the future at risk. If, as stated in the last paragraph, "all these policies are simple, if not easy, and have been suggested for years," then t question before us is: Why have the policies not been implemented?

The answer is as simple as the polic themselves: As long as the politicia from the very top on down, continue to financially supported primarily by tremely powerful private interests (in viduals and corporations) who stand lose if these policies are put in place, should not expect to see any gr changes, even in the aftermath of one the worst disasters our nation has seen disaster accurately described as "p dictable—and largely preventable."

–Aaron Gew
University of Maryl
University College in Eur
Ramstein-Miesenbach, Germ

BY PERPETUATING the false connect between global warming and hurric intensity, *BusinessWeek* trivializes the struction wrought by Hurricane Katr and detracts from serious consideratio what can and should be done to mitig the damage from similar storms in the ture. The preponderance of the actual ence, rather than speculation, is that actly the opposite is true. Hurrica

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ReadersReport

CORRECTIONS & CLARIFICATIONS

In the table (page 84) of BusinessWeek Online survey results accompanying "It's a whole new Web" (Special Report, Sept. 26), the tally of readers' favorites under Research should have been 61% for Wikipedia.org and 25% for Answers.com.

"Is IPG worth the sum of its parts?" (News: Analysis and Commentary, Sept. 19) stated that the FCB Worldwide unit of Interpublic Group of Companies could "drag the stock down." Although individual units' numbers are not broken out, an official of IPG says FCB had one of its best years ever in 2004.

In "Power from the sunbaked desert" (Science & Technology, Sept. 12), the sizes of Stirling dish farms for matching the output of Hoover Dam and of all fossil-fuel-generating plants should have been 11 miles square and 100 miles square, respectively.

The review of the book *1491: New Revelations of the Americas Before Columbus* ("Cradle of civilization," Books, Sept. 5) should have placed the ancient city of Tiwanaku in what is now Bolivia, not Peru.

frequency and severity rises and falls in a natural cycle, and hurricane researchers agree we are now unfortunately in the "high" part of the cycle. There is no evidence for the assertion that anthropogenic climate change has affected or is affecting the rate or severity of hurricanes.

–Jeff Kueter
President
George Marshall Institute
Washington

TODAY, SEPT. 2, five days after Hurricane Katrina, the only response I have seen from American corporations is the unconscionable increase in gasoline prices from the oil companies. Exxon Mobil Corp. and Chevron Corp. have both reported record earnings for the past few quarters and will probably report even higher earnings for this quarter, due to high prices at the pump, when their costs have not increased.

–James V. Showalter
San Francisco

IT IS NO COINCIDENCE that this disaster simultaneously struck one of the poorest regions of the country and crippled critical portions of our industrial and transportation infrastructure. Rich people don't live near oil refineries or work in heavy industry. For decades we have been letting our public infrastructure (roads, hospitals, bus systems, railways) crumble. The disinvestment in maintaining the levees in New Orleans is only one example. Public investment in our cities and infrastructure is critical. For example, a real mass transit system could have sped the evacuation and reduced the death toll.

Investment in our cities is a common responsibility that is properly done by the public sector. As much as large corporations may want to avoid taxes, right now most of them would have gladly have made the investment if only to have their trained workers available to repair facilities and restore commerce.

–Michael J. DeWeert
Kailua, Hawaii

A DISPASSIONATE ARGUMENT ABOUT GREEN ENERGY

TWO ARTICLES are striking in what they reveal about the priorities of our society. In "War of the screens" (International Business, Sept. 12), we learn that just two companies, L.G. Philips LCD Co. and Samsung Electronics Co., will spend $45 billion to increase the size and reduce the cost of LCD flat-panel screens for TVs and computers. In "Power from the sunbaked desert" (Science & Technology, Sept. 12), we see a technology of similar—perhaps less—sophistication that could produce "green" electricity from the sun with great efficiency.

The current modest plan by Stirling Energy is to have a 500-megawatt demonstration power plant in five years. If we do not pursue technologies like this at least as aggressively as flat-panel screens, we will have only ourselves to blame when our screens go dark.

–Don Murphy
Davis, Calif.

I AM A STRONG proponent of solar energy. But as we push for such clean technologies, it's important to get the facts right and to have a dispassionate debate about the advantages and limitations of various alternatives to fossil fuels. Solar is not an "on-demand" energy source and therefore would require some sort of energy store. Further, such dishes are obviously vulnerable to hail and wind effects.

Unfortunately, those who advocate for

solar and wind power seem to be at war with those who advocate for nuclear energy, trashing the viability of their respective technologies with half-truths, fear-mongering, and/or just bad science. The reality is that we need to press ahead with all nonfossil-based energy technologies and give those who would solve the technical difficulties of each the benefit of the doubt. The real enemy is continuing to rely on oil and coal.

–Michael V. Micotto
Webster Groves, Mo.

> "Doesn't competition encourage students to strive harder?"
>
> *–Lauren J. Kopal*
> *Danbury, Conn.*

THE SHRINKING VALUE OF THAT SHEEPSKIN

MICHAEL J. MANDEL'S "College: The payoff shrinks" (News: Analysis & Commentary, Sept. 12) on the wage stagnation of the college-educated was timely but unfortunately missed a key point. Many employers recognize that colleges today suffer from "grade inflation." The near-automatic graduation of college students who do little besides pay tuition, attend class, and act responsibly has diluted the college-educated workforce. The baccalaureate degree is supposed to distinguish its recipients as interested, literate, and able to analyze and problem-solve. As this guarantee is eroded, so is the confidence of employers in the quality of the college-educated.

–Alvin Hutchinson
Washington

WE HAVE TO FACE reality: The U.S. is a declining economic power. Instead of claiming to be the only superpower, we should accept the new reality—that we are a relatively rich Third World country with the rest of the world owning our financial assets. My advice to our kids: Forget college—it is not worth it. Corporate America has made sure of it.

–Ashni Behal, M.D.
Lima, Ohio

THE BEST WAY TO GRADE STUDENTS—AND JOB CANDIDATES

IS IT NOT THE higher-educational institution's responsibility to train and form individuals with accountability and a high standard in decision-making, especially at a Master's or PhD/M.D. level ("Campus confidential," Management, Sept. 12)? And doesn't competition encourage students to strive harder and excel? Grades are a reflection of who we are. They represent our academic achievements as well as our ability to manage stress and our personal lives. They are a great motivator. Removing accountability removes motivation and inherent boundaries that help many people to strive. During an interview, a candidate can shine while explaining a challenging elective and the experiences learned from it.

–Lauren J. Kopal
Danbury, Conn.

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Simple Solutions

EVEN IF YOU'RE NOT into exotic subjects such as particle physics, cosmology, or math theory, chances are pretty good that you know about Mathematica, the program created by physicist Stephen Wolfram. He's the iconoclastic London-born genius who won a PhD from California Institute of Technology in just one year, at age 20.

Since Mathematica's launch in 1988 by Wolfram Research Inc., the software has become hugely popular among product designers, architects, and financial analysts. And for engineers and scientists, Mathematica is something of a bible. Wolfram's software is used not only to solve complex math problems but also to create and analyze computer models. It can predict how varying the ingredients in a shampoo will alter its flow through different-size bottle openings, for example, or how the pounding of ocean waves will affect a breakwater.

Stephen Wolfram's Mathematica software nails complex puzzles

Mathematica quickly made Stephen Wolfram a multimillionaire—and funded more than a decade of independent research into fundamental issues in science. But the program wasn't just a cash cow. It was Wolfram's primary tool in searching for the principles that govern a wide range of enigmas, from how the universe was formed to why zebras have stripes.

After finding simple, algorithmic answers to many questions that remain unexplained by traditional theories, Wolfram self-published the results of his work in a controversial 2002 book called *A New Kind of Science*. It's a dense tome of 1,200 pages, yet it has sold more than 200,000 copies, at up to $45 a pop. In addition, some 500,000 people have downloaded free chapters or entire copies from www.wolframscience.com.

A lot of mainstream scientists scoffed at NKS, Wolfram's shorthand for *A New Kind of Science*. Nobel laureate Steven Weinberg, a University of Texas physicist, writing in *The New York Review of Books*, labeled the book a "failure," but "an interesting one."

Was Wolfram disappointed? Nope. "What I'm trying to do is make a new kind of science, not win a Nobel prize," he says. To show that his ideas are starting to catch on, he points to a steadily growing stream of scientific papers "following up on NKS." The number of papers is climbing toward 1,000, with roughly 15 cropping up every week in peer-reviewed journals.

Since finishing his book, Wolfram, who turned 46 in August, has been developing new and more advanced algorithmic tools for Mathematica while also pondering the almost limitless applications he sees for NKS. "Look at almost any area—nanotechnology or drug design or network routing or all sorts of other things—and NKS can provide fascinating insights and new technologies."

One that has just emerged is dubbed WolframTones. It's an NKS program on a Web site (http://tones.wolfram.com) that people can use to create unique ring tones for cell phones. WolframTones was "almost frivolously conceived," the physicist admits: He wanted his own cell phone to have a distinctive ring and his program worked better than expected.

The next revision of Mathematica won't be the least bit frivolous, though. "It will end up being the biggest change since version 1," Wolfram declares, because it will "go incredibly much farther. I myself need the things we're building to go to the next level of NKS." He hopes to discover the program that runs the universe—meaning the entire universe and everything in it. He's betting it will be an astonishingly simple program, like all the others in NKS: probably just a handful of lines of Mathematica code. ■

–By Otis Port

BusinessWeek online For a debate between controversial authors Stephen Wolfram and Ray Kurzweil on the digital nature of nature, go to businessweek.com/mediacenter/list/technology002.htm

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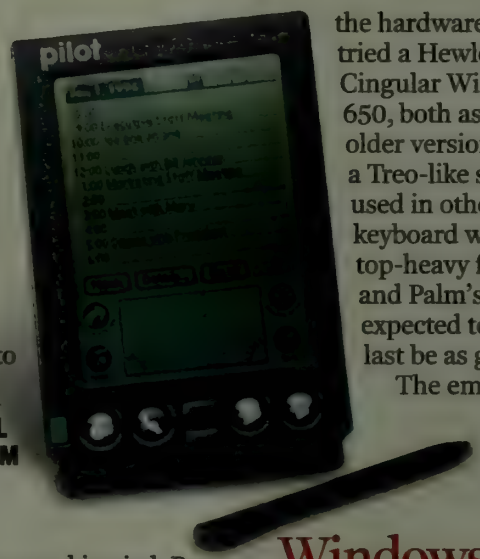
BY STEPHEN H. WILDSTROM

Look Who's Powering Palm

Is the Palm software that powered the first practical handheld in 1996 and redefined mobile computing on the road to oblivion? It sure looks that way, at least for devices such as Palm's popular Treo, which combines voice and e-mail service with the traditional contacts and calendar functions of a PDA. Palm will soon announce a Treo powered not by Palm OS software but by Microsoft's Windows Mobile 5. And while Palm will sell both Palm OS and Windows Treos for the indefinite future, Microsoft software is likely to dominate the market over time.

The sale of PalmSource, the software arm spun out of the former Palm Computer in 2002, will also affect the future of Palm OS. PalmSource had been struggling both to find more customers and to get its products, particularly a simpler operating system for cell phones, to market. Earlier this year it sold its share of the Palm trademarks back to the hardware arm and put itself up for sale.



THE ORIGINAL 1996 PALM PILOT

As the only significant licensee of Palm OS, Palm was widely expected to buy back the software business—and it tried. But major U.S. and European handset makers jumped into the bidding and drove the price sky-high. "There was a point beyond which we didn't think it made sense," Palm CEO Ed Colligan wrote in an e-mail to Palm employees that was obtained by *BusinessWeek*. After Palm withdrew, Japanese software maker Access, which supplies Web browser technology for the Treo, came up with the winning bid: $324 million in cash, an 83% premium over the market share price.

FOR PALM THE ACCESS DEAL is the least objectionable outcome since it prevented Palm OS from falling into the hands of a competitor. Palm is not likely to shift away from Palm OS as the software behind its Zire, Tungsten, and LifeDrive PDA models. But the market for these nonphone handhelds has been declining for several years as wireless handsets take up more of their functions. And with the acquisition of PalmSource now off the table, Palm can be agnostic about its software choices.

Although I have long been a Palm fan, I have to concede that Microsoft software increasingly makes sense for a converged device like the Treo. The first Pocket PC Phone Editions, which came out three years ago, were ghastly, but the hardware and software have steadily improved. I tried a Hewlett-Packard iPAQ HW6500, due this fall from Cingular Wireless, and it was nearly as good as a Treo 650, both as a phone and for e-mail—and it uses an older version of the Windows Mobile software. HP used a Treo-like square display instead of the elongated ones used in other Pocket PCs. This left room for a built-in keyboard while keeping the device compact and not too top-heavy for typing. Between the improved software and Palm's Treo design experience, the Windows Treo, expected to hit the market early next year, should at last be as good as the Palm OS-based Treo 650.

The embrace of Microsoft is bound to cause howls of betrayal among Palm faithful. But the time is ripe for Palm to move to Windows Mobile. The hardware inside Treos and Pocket PC phones is virtually identical. Windows Mobile is popular with corporations, especially those whose mail systems are built on Microsoft Exchange and Outlook. And the fact that programs can be written to run on both Treo-size devices and the smaller, cheaper Windows Mobile Smartphones, such as the Audiovox SMT 5600, appeals to both companies and independent software developers.

Windows Mobile is now nearly as good as Palm's software

Microsoft may be a company of predatory instincts, but its history of competition with Palm is typical of how it so often wins in the end. With the patience conferred by deep pockets and the determination to keep trying, it can eventually penetrate any market it desires. Palm held off the juggernaut for longer than most, but the time for change is rapidly drawing near. ■

E-mail: techandyou@businessweek.com

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Mastering Hemophilia

Winning Freedom

Science For A Better Life

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BY JON FINE

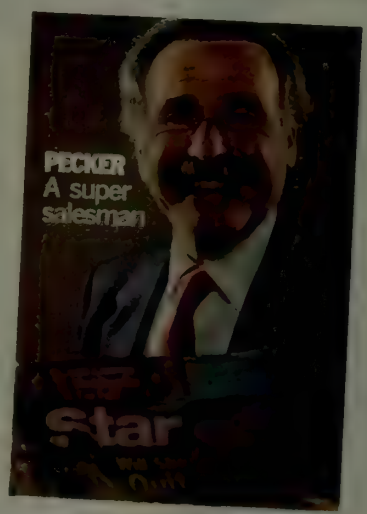
Media, Marketing, and Advertising in the 21st Century

Inquiring Minds Want Results

How weird is the print world these days? You can't even count on appealing to the lowest common denominator. ¶ This is the reality fac David Pecker as chairman and CEO of American Media Inc., publisher *The National Enquirer*, *The Star*, and *Shape*. ¶ Pecker speaks, at hypersp with a Noo Yawk accent that's all rasp and sinus. His father laid bricks in the Bronx. He became a mogul.

In 1991, at 40, Pecker became CEO of Hachette Filipacchi's U.S. magazine division, which owns *Elle* and *Road & Track*. Pecker is a cost-cutter's cost-cutter, and he boosted revenues and profits. An accountant by trade, he remade himself into a relentless salesman. (I once saw him hit a roomful of private equity guys with a sell so audacious that some audience members weren't sure whether to guffaw or write checks.) A plan to take his unit public was rejected, and he split for a better deal.

That led to his current post. Pecker's scorecard reads like this: He has spent a hair under $1.3 billion acquiring companies that for the fiscal year ended Mar. 31 posted earnings before taxes depreciation, and amortization (EBITDA) of $134 million on revenues of $536 million.



FOR THE AVERAGE MAGAZINE COMPANY, these are solid numbers. But American Media is not average. Unlike other major magazine companies, it's owned by private equity investors—Thomas H. Lee Partners and Evercore Partners. And private equity demands serious returns that, so far, Pecker isn't delivering. American Media is carrying close to $1 billion in debt, as of June 30. EBITDA fell over 20% in each of the past two quarters. Standard & Poor's (owned, like *BusinessWeek*, by The McGraw-Hill Companies) downgraded the company's outlook to negative in August.

Executives at Evercore and Lee express confidence in Pecker. But they'd be right to feel nervous. The core fact of American Media is its massive newsstand-sales erosion. None of its strategies, acquisitions, or new launches have overcome this. Newsstand sales still account for more than half of American Media's operating revenue. This is not encouraging. In the first half of 1999, the *National Enquirer* sold 1.8 million newsstand copies; in the first half of '05 it sold 947,000. In the same time frame, the *Star*'s sales fell from 1.4 million, to 879,356. An expensive bid to glam up the *Star* under Bonnie Fuller (who, for good or ill, invented *Us Weekly* as we know it) has not stopped the slide. P hikes have kept circulation revenues stead Pecker admits, there's no more pricing leve Any revenue pickup now "has to come fro volume," he says.

Then there's Arnold. Recent reports on American Media's dealings with California Governor Arnold Schwarzenegger included revelations of a now-terminated seven-figur consulting gig and controversial journalistic tactics involving coverage of the governor. (declines to comment except to say he's not involved in news-gathering.) Silver lining: Si American Media is not exactly *The New York Times*, this may not spook advertisers.

All this puts a CEO prone to grandiose tall the position of preaching modesty. 2003, Pecker vowed to build a $1 bi company. Last year he talked up pla to take his company public within 1 months. Last November he predicte American Media's revenues would r to $600 million this year and post EBITDA of $200 million. Now he sa '06 will bring in revenues around $5 million and EBITDA of around $145 million. The IPO is on the back burne "We have to show some traction," he says. "Thank God, [advertising] resu at the *Star* have been pretty good." (They have, off a small base.)

Times are tougher for David Pecker's tabloid empire

Still, Pecker has done pretty well. He has several homes, base salary of $1.5 million, and hobnobs with the likes of Sylvester Stallone, with whom he's testing a magazine calle *Sly*. But "to tell you the truth, it hasn't been fun" dealing wi celebs, says Pecker. "Sly's been unbelievably aggressive" in his demands for his magazine. Maybe this mogul thing isn't all it's cracked up to be. But it's a little too late to realize that just as it's late to realize, in an increasingly tabloidized culture, that the tabloids themselves may be dispensable. ■

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The Barker Portfolio

BY ROBERT BARKER

Bargains Among Busted IPOs

One summer morning, the sun dawned wicked hot over Wall Street, where the watchword was Baidu.com. If Baidu meant nothing to you, oh how out of it you were. Billed as the Google of China, Baidu went public at 27, opened that day at 66 and swiftly hit 151. Lately it goes for 80. Baidu, it seems, must be Mandarin for Inefficient Market Hypothesis.

Managed by the Street's sharpest marketers, stocks sold in initial public offerings can take years to settle into some facsimile of rational trading. Then, after the deal hype wears off, you might stand a reasonable chance of finding a value in so-called busted IPOs, or stocks that have sunk below their initial prices. As the volume of IPOs has picked up—216 in 2004, plus 126 more through Sept. 19, according to Renaissance Capital's IPOHome.com—I've begun to wonder: Are there busted IPOs worth buying?

So I asked two data outfits, Standard & Poor's Capital IQ unit and Morningstar, to help me come up with a list of possibilities. We restricted the search to U.S. companies that have gone public since Jan. 1, 2002, and then I further limited it to companies that now have at least $1 billion in market value. Finally, I excluded those without net profits and trading at a multiple of enterprise value (market capitalization plus net debt) to EBITDA (earnings before interest, taxes, depreciation, and amortization) of nine or more. If the criteria are arbitrary, in the end I had four very different companies (table).

» ADESA. This is the Sotheby's of used and beaten-up cars. It collects fees by matching sellers with buyers, both online and in person at 53 used-vehicle auction sites and an additional 32 salvage locations across North America. In the June quarter, ADESA moved 494,482 vehicles, collecting an average of $436 on each, a 6% gain from the average take in 2004's June quarter. Through the first half, total revenue rose 3%, to $492 million, and net income increased 15%, to $71 million. Based in Carmel, Ind., ADESA also finances used-car dealers' inventories, which contributes 12% of total revenue.

» ADVANCE AMERICA, CASH ADVANCE CENTERS. This Spartanburg (S.C.) company exploits an unhappy growth phenomenon: "payday lending," or unsecured short-term but high-cost loans to people who are strapped for cash. The average loan runs $334. Naturally, this chain of 2,520 lending offices in 35 states is defensive about being seen as a loan shark and is widely attacked in courts and statehouses by consumer groups and rival lenders. In Georgia it was forced to give up and shut down. Just the same, it keeps growing, and the stock comes with a 2.8% dividend yield.

» AMIS HOLDINGS. A maker of specialty semiconductors, AMIS supplies chips for a wide variety of products, from autos to cardiac pacemakers. Based in Pocatello, Idaho, AMIS in September closed on a $138 million deal for Flextronics International's semiconductor unit, which at current rates might add $75 million or so to its $493 million in annual revenues. It expects the new addition to expand sales in Asia, which now come to just 18% of the total, and hopes also soon to be named one of Flextronics' preferred suppliers. Chief Financial Officer David Henry told me AMIS is intent on lowering its debt, a relatively high 54% of total capital.

» HUNTSMAN. Netting nearly $1.5 billion on its February IPO, this Salt Lake City chemical giant (2004 revenues, $11.5 billion) so far is the year's biggest new issue. Sadly for investors, it has been a dog, with shares off 24% from the IPO. Worth noting, however, is that Huntsman's fall is about in line with such global rivals as Dow Chemical and DuPont. Higher crude oil and natural gas prices are hurting—and will continue to hurt—until the chemical companies can start recouping higher costs via price hikes. Meantime, shares of Huntsman trade at multiples lower than better-known peers.

All these stocks are unlikely to rebound soon. But to me they beat hoping to catch Baidu's next manic swing. ■

E-mail: rb@businessweek.com

Scuffed Jewels?

	ADESA	ADVANCE AMERICA, CASH ADVANCE CENTERS	AMIS HOLDINGS	HUNTSMAN
Symbol	KAR	AEA	AMIS	HUN
Industry	Car auctions	Consumer credit	Semiconductors	Chemicals
IPO Date	6/15/2004	12/15/2004	9/29/2003	2/10/2005
IPO Price	$24.00	15.00	20.00	23.00
Post-IPO High Price	$25.90	23.94	21.85	30.00
Recent Price	$22.45	12.82	11.96	17.48
EV/EBITDA*	8.7	7.9	8.9	5.7
2006 EPS**	$1.56	1.08	0.75	3.09
Debt-Capital Ratio	33%	10	54	73

*Ratio of enterprise value to earnings before interest, taxes, depreciation, and amortization for the past 12 months **Estimates

Data: Capital IQ, ComStock, Morningstar Inc., Renaissance Capital Corp.'s IPOhome.com

Y JAMES C. COOPER & KATHLEEN MADIGAN

America's Trade Deficit: Expect Some Storm Damage

atrina's bill may include a steeper trade imbalance and a weaker dollar

U.S. ECONOMY Economists had expected the U.S. current-account eficit, the broadest measure of the nation's international balance of ayments, to begin to stabilize in the second half of 2005 and perhaps ven narrow in 2006. Faster growth abroad, a cooler U.S. economy, nd a weaker dollar would cause improvement in the U.S. trade posi-

n. Indeed, the gap fell slightly in the second quarter. t that news preceded the summer spike in oil prices d Hurricane Katrina. Those two shocks, along with the ound in the dollar, challenge the idea that a correction the current account is imminent. And they revive fears t the adjustment may not be painless, as U.S. pendence on foreign financing grows ever larger.

The current-account balance is the sum of all foreign nsactions, including trade in goods and services, come payments, and government transfers. For years, e main focus has been the deteriorating merchandise de deficit as goods imports swamped exports. But now e U.S. surplus in services has been slipping, and foreign estors are earning more from U.S. assets than nerican investors are earning abroad.

Surging oil prices and the enormous stimulus coming m government spending on post-Katrina rebuilding eaten to make this bad situation worse. Not only will stlier oil and other energy imports directly lift the U.S. port bill but stronger economic growth, thanks to fiscal mulus, will boost demand for non-oil imports.

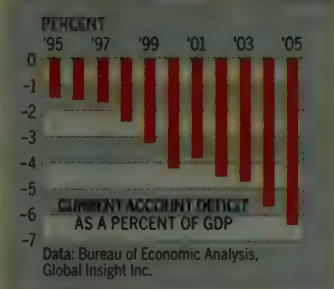
Equally important, higher energy costs are slowing nomic growth abroad more than they have U.S. wth, curtailing demand for U.S. exports. Moreover, so this year the dollar is up more than 11% vs. the euro d 9% vs. the yen. Against this backdrop, it's likely that e current-account deficit, which stood at an annual rate $778.6 billion, or 6.4% of gross domestic product in e first half (chart), will top 7% of GDP next year.

FAR, FOREIGNERS remain eager to finance this assive imbalance. International investors are supplying e U.S. with some $65 billion in new lending every nth without the often-predicted dire consequences for e dollar, inflation, and interest rates.

In fact, some have argued that the deficit is not a hcern. In this new era of global co-dependency, erging nations depend on developed foreign markets support their growth, while the U.S. and other veloped countries benefit as new capital flows back in investing. Former Treasury Secretary Paul H. O'Neill ce went so far as to say that the current-account deficit s "an antiquated theoretical construct."

However, this theoretical construct may run up against some hard realities in the coming year. First, with a deficit heading toward 7% of GDP, the U.S. will need foreign investors to pony up close to $80 billion per month next year, a 23% jump. Investors may well demand a higher rate of return to lend so much money. That means the dollar may have to fall substantially in order to make U.S. assets sufficiently attractive to balance the appetite for U.S. financing against the willingness of foreigners to satisfy it.

STILL YAWNING, AND SET TO GET WIDER



Data: Bureau of Economic Analysis, Global Insight Inc.

Second, government spending has taken a turn for the worse. Back in February, the louder "voice of fiscal restraint" gave Federal Reserve Chairman Alan Greenspan hope for a benign adjustment in the current-account imbalance. "If actions are taken to reduce federal government dissaving, pressures to borrow from abroad will presumably diminish," he said. Instead, federal dissaving, also known as the budget deficit, is set to grow, not shrink. Katrina costs, which could generate more than $100 billion in new financing needs by the Treasury, will add pressure on the markets.

THIRD, INTEREST RATES are set to move up. The Fed hiked the federal funds rates by another quarter-point on Sept. 20, to 3.75%. The Fed's statement suggested that Katrina effects would be temporary, and it alluded to concerns that higher energy and other costs could add to inflationary pressures. In sum, the Fed seemed to say, don't expect a pause in rate hiking anytime soon.

With rates rising, the cost of servicing America's overall volume of foreign debt of roughly $2.5 trillion will also increase. Moreover, the growing current-account deficit will add to that outstanding debt volume every year. Already, the U.S. is paying out more income on the growing stock of U.S. assets held abroad than the amount

paid to American investors for foreign-issued assets. In the second quarter, the balance on income in the current account slipped into deficit from a record surplus of $17.7 billion just 1½ years ago (chart).

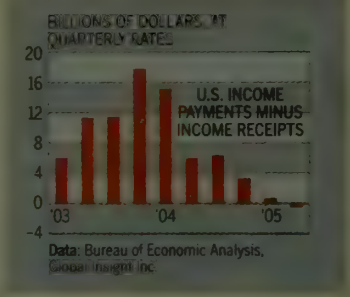
Given the dearth of consumer savings and the outright drain on the national piggy bank coming from the federal deficit, the U.S. has little choice but to borrow from abroad to finance its investment and growth.

Generally, foreign confidence in the performance of the U.S. economy and the soundness of its economic policies will determine the overseas appeal of U.S. stocks and bonds and the willingness to set up operations in the U.S. However, foreign appetites can wane for reasons other than U.S. growth prospects. For instance, Japan has been a key buyer of U.S. securities in recent years. But if Japan's economy is finally turning the corner, then Japanese investors may prefer to invest at home.

IF FOREIGN INVESTMENT PATTERNS shift, the dollar is sure to resume its decline, and that has consequences for inflation and interest rates. In the past, foreign producers preferred to guard their market share by absorbing most of the dollar's decline and allowing their profit margins to shrink. But with businesses worldwide facing sharply higher energy costs, foreign manufacturers may have to raise their prices to cover their fuel bills. If inflation picked up at the same time that foreign investors began to demand a better rate of return to buy U.S. securities, the end result would be much higher interest rates, perhaps quite quickly since market sentiment, especially where inflation expectations are concerned, can shift on a dime.

A rapid rise in interest rates would slow U.S. growth. The housing sector, which has become hugely dependent on cheap mortgages to boost demand, would be most vulnerable to a sudden hike in long rates.

THE INCOME BALANCE TURNS NEGATIVE



In turn, the Fed would be faced with price pressures from abroad, even as fiscal stimulus is lifting inflation at home. To fight inflation on both fronts, the Fed may have to hike interest rates more aggressively than the financial markets expect. However, higher rates would increase the amount of interest going to foreigners, causing further deterioration in the current account.

True, worries about the current-account deficit's effect on growth, interest rates, and inflation have arisen before in this business cycle. And those fears have taken on almost a "cry wolf" quality—since foreigners still seem willing to lend the U.S. money and currency traders keep their faith in the value of the dollar.

But the pressure on the current account is growing again. And it's important to remember that in the bedtime story, the wolf does eventually show up. ■

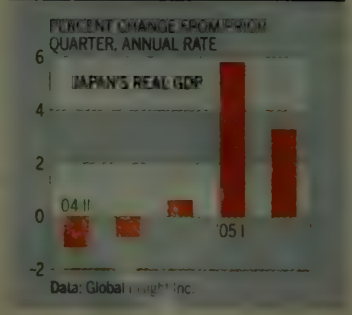
JAPAN

Land of the Rising Hopes

IS IT TIME to be optimistic about Japan? The answer seems to be yes, as evidence mounts that the economy is about to emerge from its deflation spiral while also benefiting from past corporate reforms. The most important sign: For the first time in more than a decade, private-sector demand is driving growth, instead of exports or government outlays.

Revised data on gross domestic product show the economy grew at a 3.3% annual rate in the second quarter, with solid advances in consumer and capital spending. The gain was triple the initial estimate, and it followed a 5.8% gain in the first quarter.

GROWTH SHOWS NEW STRENGTH



Both corporations and households are starting to benefit from corporate restructuring. Since the Asian Crisis in 1997, companies have relocated production to other Asian nations, especially China. The moves boosted Japan's profitability but severely crippled its labor markets. Now those profits are powering capital spending, which is generating jobs and income for consumers. Average wages have turned up, reflecting more full-time jobs. In July, available jobs per applicant were the highest since 1992. And both winter and summer bonus payments were up from the year before, the first back-to-back gains since 1996.

Crucially, after suffocating under an avalanche of bad loans, banks are breathing again. Banking consolidation and recovery is providing the financial fuel the private sector needs to sustain growth. In August, adjusted bank lending posted its first 12-month rise in years, says the Bank of Japan.

With the domestic economy firming up, so are prices. After five years of deflation, prices have all but stabilized, and the BOJ believes the inflation rate will move into positive territory by the turn of the year. Even so, the central bank is not expected to start lifting interest rates for a long time, since it was severely criticized for tightening too early five years ago when recovery seemed imminent.

If so, that would set up a very accommodative monetary policy for 2006, since with the BOJ holding rates at zero, any pickup in inflation would result in negative real rates. Such a policy alongside solid growth would suggest a bright outlook for assets, from stocks to real estate. ■

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STRATEGIES

AOL GOES FROM DOG TO DIAMOND

Its new lease on life gives Dick Parsons a chance to boost Time Warner stock, excite shareholders, and quiet Carl Icahn

BY TOM LOWRY AND CATHERINE YANG

IT'S NO SECRET THAT TIME Warner CEO Richard D. Parsons loves a party, especially one thrown in his honor. So there he was on Sept. 20 schmoozing in a sea of tuxedos and sequined gowns at Manhattan's Pierre Hotel. The A-list had gathered for a dinner given by the Jewish Theological Seminary to honor the business and philanthropic efforts of Parsons and his wife, Laura, a child psychologist. Clearly, the 57-year-old executive, shaking hands and giving hugs, was soaking up the recognition.

And why not? Since taking the top job in May, 2002, Parsons has faced plenty of critics. Many shareholders, bitter over the ill-fated AOL-Time Warner merger, excoriated the CEO, demanding he jettison America Online and free the media empire of its biggest burden. But Parsons put his head down and methodically cleaned up a series of messes. He sold off businesses, reduced debt, resolved federal accounting investigations, and moved to settle shareholder lawsuits. And while the stock is trading at 18, where it was when he took over, today shareholders have eased up on AOL and taken a wait-and-see approach.

Indeed, AOL is emerging as a key weapon in Parsons' fight to keep shareholders in his camp—and from joining forces with Carl Icahn. The infamous corporate raider has snatched up 3% of Time Warner's stock and has threatened to launch a proxy fight to get the stock moving again. While Parsons has announced plans to spin off 16% of Time Warner's cable unit and buy back $5 billion in stock, Icahn wants to force Parsons spin off all of cable and spend $20 billi on Time Warner shares.

Instead, Parsons is counting on a r vival at AOL, newly reborn as a portal, get investors excited about Time Warne stock again. Not only is AOL benefiti from a surge in online advertising b Time Warner has held talks—now hold—with former arch-foe Microso Corp. about linking up with the MSN I ternet service, the No. 2 portal. Combi the interest from Microsoft and AOL's a cendancy as an advertising play, and t Internet unit suddenly looks a whole l more valuable. Analysts say AOL could worth $15 billion to $20 billion—up twice its valuation just two years ag Says Mitchell Rubin, lead manager f Baron Fifth Avenue Growth Fund,

SO IN THIS SECTION:

7 Disney: A Pixar deal may be on the way

38 An Apple video iPod? Rivals plan to be ready

40 The makeover at Microsoft

44 A Conservative New Deal for the Gulf Coas

ARSONS Will
OL link up
ith Google or
SN—or keep
ying solo?

Time Warner shareholder: "I still see the potential for the AOL business as huge."

That prospect would go a long way toward helping lift the beleaguered stock—and for now, it's helping Parsons keep Icahn at bay. Investors told *BusinessWeek* that, while having Icahn riding herd on Parsons isn't a bad thing, they would rather give Parsons a chance to make the portal strategy work before doing something drastic like spinning off cable. "Shareholders at this point are investing in management," says Henry Ellenbogen, an analyst at T. Rowe Price Group Inc., a Time Warner shareholder. Adds media investor Mario J. Gabelli, whose firm owned 16 million shares of Time Warner as of June: "If Parsons can get AOL right, it could boost that business' valuation from about $20 billion to $50 billion someday. I say stay the course."

Time Warner headquarters in New York

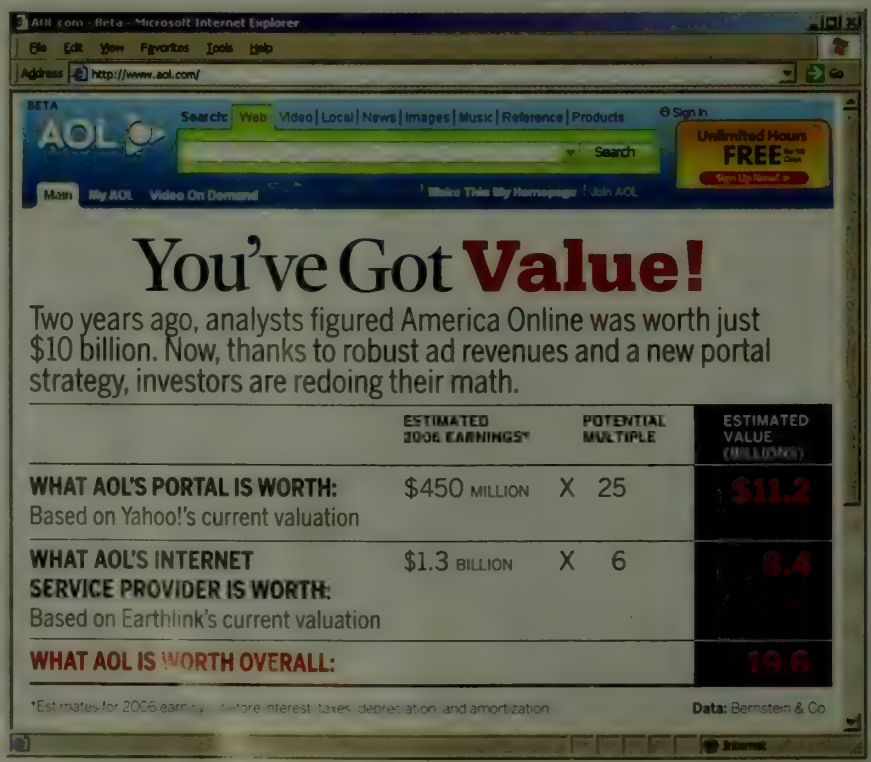
MATCHMAKING

THE QUESTION FOR Parsons is whether to stick with Plan A—going it alone with the AOL portal strategy—or to tie up with MSN or even Google Inc. (page 88). Merrill Lynch & Co. analyst Lauren Rich Fine speculated on Sept. 16 that Google might consider a deal. Google, which already provides search technology and shares ad revenues with AOL, declined comment. For now, Parsons vows to accelerate the AOL portal strategy. On Sept. 21 he told a Goldman, Sachs & Co. investor conference: "The biggest growth opportunity for us is in AOL." Still, Parsons is considering all options, including selling off a minority stake in AOL. It's all good as far as investors are concerned. "AOL is the final remaining issue for Parsons," says Jerome W. Walther, executive vice-president of Church Capital Management, which owns 350,000 Time Warner shares. "I'm happy to see he's being proactive and seeking alternatives."

It's easy to see why many are giving AOL another look. After several years of watching revenues slide as dial-up subscribers deserted the service in droves, the online unit over the past nine months has focused more on the fast-growing Internet ad market. On July 21, the free aol.com Web site relaunched as a hub to help generate traffic among AOL's properties—including AOL Instant Messenger, AOL Music, and MapQuest. About 112 million monthly unique visitors go to those sites, helping to generate $1 billion in ad revenues for AOL last year. Now, with the effort to gain an ever-bigger audience f its Web sites, AOL is likely to rack $1.35 billion in ad revenues this year, Fulcrum Global Partners.

Even if AOL's revenues continue to cline with its subscribers—900,000 during the second quarter alone—company hopes growth in ad profits. A all, about 50¢ of e dollar of ad revenues to the bottom line, vs. 20¢ of every subscrip dollar, says AOL Jonathan F. Miller. All while, AOL continue launch services to new users. On Sept. 2 announced the rollou a voice-over-Inter protocol phone ser following similar m by eBay and various c companies. AOL is ir ducing original progr to its flagship Web too. They include *The* a reality show where contestants vie to st record label at Wa Music Group Corp.

Given investors' en siasm for the AOL stra



You've Got **Value!**

Two years ago, analysts figured America Online was worth just $10 billion. Now, thanks to robust ad revenues and a new portal strategy, investors are redoing their math.

	ESTIMATED 2006 EARNINGS*	POTENTIAL MULTIPLE	ESTIMATED VALUE (BILLIONS)
WHAT AOL'S PORTAL IS WORTH: Based on Yahoo!'s current valuation	$450 MILLION	X 25	$11.2
WHAT AOL'S INTERNET SERVICE PROVIDER IS WORTH: Based on Earthlink's current valuation	$1.3 BILLION	X 6	8.4
WHAT AOL IS WORTH OVERALL:			19.6

*Estimates for 2006 earnings before interest, taxes, depreciation, and amortization

Data: Bernstein & Co

would Parsons risk a tieup with MSN? There are pros and cons. On the plus side, a combined AOL and MSN, which itself boasts 100 million unique visitors a month, would easily top rival Yahoo! Inc., which has 122 million monthly unique visitors, according to comScore Media Metrix. That would make the duo much more attractive to advertisers. "A combination of AOL and MSN would turn the industry on its ear and make us reassess our assumptions of the power players," says Jeff Lanctot, vice-president for media at Avenue A/Razorfish, a unit of Seattle online ad agency aQuantive Inc.

On the other hand, a deal with MSN would almost certainly mean ending AOL's lucrative partnership with Google. One third of AOL's second-quarter $320 million in ad revenues came from its search deal with Google: In exchange for directing AOL users to Google for searches, AOL receives 80% of paid search revues generated. If, in switching to MSN arch as part of the deal, AOL were unable command the same interest as Google m advertisers and users, it would lose a bstantial and growing revenue stream. 's risky for AOL, unless they get a big yoff [from Microsoft]," says David Card, Internet analyst at JupiterResearch.

PSIDE DOWN?

ANY SHAREHOLDERS feel much the me way. While intrigued by a partnerip for AOL, they want more details. "It ems like a waste if you give too much vay, especially since it's the one sector of edia growing by leaps and bounds," ys Baron Fifth Avenue's Rubin.

And as Parsons woos shareholders, he ust keep an eye on Icahn, who thinks rsons' priorities are upside down. Vhile we think AOL is undervalued and e would study and maybe embrace alnatives," Icahn told *BusinessWeek*, "we ll think the greatest value enhancer, the vel here, is splitting off cable and buyg back $20 billion of stock."

For now, Parsons appears to have the ge over the notoriously dogged raider. his strategy works and Time Warner ares get out of neutral, who knows? It ght even be Icahn who throws Parsons next party. ■

–With Ben Elgin in San Mateo, Calif.

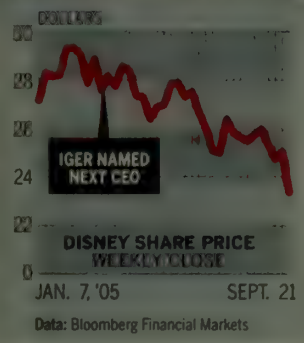
MANAGEMENT

Calming the Crowd After Eisner's Thrill Ride

Robert Iger has been waiting a long time for this moment. On Oct. 1 he finally takes over as CEO of the beleaguered Walt Disney Co., six months after being selected to succeed embattled Michael D. Eisner. For many investors, executives, and board members, bringing an end to the stormy final years of Eisner's two-decade turn at the helm couldn't have happened soon enough. Now, with Eisner out of the way, it will be all Iger's show.

Is Iger, 53, up to the task of turning around a company that has become a 9-to-5 soap opera? After years filled with lawsuits and boardroom rebellion, Disney has already made some progress under Iger. Since being named on Mar. 13, Iger has patched up a yearlong battle with dissident former board members Roy Disney and Stanley Gold. What's more, Disney's long-suffering ABC network is enjoying a comeback, and ESPN is generating a tidy stream of cash.

NOT MUCH MAGIC



Data: Bloomberg Financial Markets

But none of that is enough for Wall Street, which has dissed media stocks of late and focused on the company's movie-studio woes. Since Iger was tapped, Disney's share price is off some 15%. Iger knows he has a big sales job to do. Says Iger: "We have great, underappreciated brands."

Iger could be on the verge of overcoming one of the major hurdles toward winning back investors: signing a new deal with Steve Jobs' Pixar Animation, which made such blockbusters as *Toy Story* and *The Incredibles* for Disney. It won't come easy—or cheap. But Disney insiders say Iger is making headway. While Eisner and Jobs dueled incessantly, Iger has enjoyed cordial phone calls and e-mail exchanges with Jobs. More important, Disney studio chief Richard W. Cook has been making frequent trips to Pixar's Emeryville (Calif.) headquarters.

A compromise might be reached by late this year, insiders say. It could have Pixar ending its 14-year 50-50 joint venture with Disney, with Pixar paying all production costs and giving Disney 6% of studio film revenue. Disney would hang onto the rights to older Pixar films, as Jobs wanted, and sign a long-term contract to sell Pixar merchandise. Neither Jobs nor Iger would comment on the talks. "The deal is complicated and has to make sense to two sets of shareholders," says Iger.

Even a Pixar deal won't solve all of Iger's problems. With the media industry in a slump, Disney suffers from advertising woes, a limp box office, weak DVD sales, and competition from the Net. Its lackluster summer will saddle the company with $300 million in losses next quarter.

Iger has a plan. He's spearheading a move to distribute Disney films and TV shows digitally on phones and directly to homes—crucial for a company without cable or satellite operations. Disney is also thinking of selling some of its 71-station Radio Disney chain to focus on other assets.

For now, much of Wall Street remains unconvinced. But Capital Group's Gordon Crawford, a bellwether among media investors, has started to pay attention. Crawford once said he would never buy more Disney shares under Eisner. He isn't commenting, but Capital, which now owns 33.7 million Disney shares, has increased its stake by 15,000 shares in recent weeks. It's not a lot, but for Disney, the new era may start with mouse steps.

–By Ronald Grover in Los Angeles

CONSUMER ELECTRONICS

WHO'S AFRAID OF STEVE JOBS NOW

He says no video iPod plans are afoot, but potential rivals aren't taking any chances

ASK STEVE JOBS TO describe the "next big thing" for Apple Computer Inc., and a video iPod seems the furthest thing from his mind. For years, Apple's CEO has dismissed the idea of portable video players, insisting that no one wants to watch movies on tiny screens. Then again, he pooh-poohed an Apple-branded music player just months before releasing his iconic white gadget in 2001. What's more, two Hollywood execs say Apple has held talks with movie studios about downloading movies to PCs. While Jobs may be more interested in developing such technology to make it easier for Macintosh users to get movies at home, the talks have prompted speculation that the notoriously secretive Jobs will eventually launch a video iPod.

Whether Jobs's skepticism is real or simply a clever feint, rivals aren't waiting to find out. Convinced that a potentially huge market exists for portable video players, they're rushing to pack more technology and bring more content to the latest generation of models. Companies such as EchoStar Communications' DISH Network, Samsung, and Creative Technology are bringing out a host of feature-laden new players in time for the holidays that are aimed at making them as synonymous with digital video as Apple has become with digital music. And by adding the ability to download shows such as *Desperate Housewives* or sports clips, competitors hope to beat Apple to the punch in wooing consumers. "The availability of content becomes more important when you talk about video, and the big difference between us and Apple is we already have it—and they don't," says Mark Jackson, president of EchoStar Technologies Corp.

Trouble is, Apple's rivals in the digital music market were singing the same rosy tune before the iPod demolished them. In 2002, Creative's Nomad products and Diamond Multimedia Inc.'s Rio-branded digital music players were the industry leaders, battling over which company had the better technology. Apple jumped onto the scene, boosting the sleepy market from 1.8 million units sold in 2001 to nearly 30 million this year. It quickly won 85% of the still-gro ing market by combining great hardw and software that made music downlo a snap with a multimillion-dollar mark ing campaign that convinced consum that the iPod was the coolest thing si the Sony Walkman. The result: In l August, Rio exited the market, and C ative remains awash in red ink a spending millions on advertising i failed effort to boost its market share.

CONTENT IS KEY

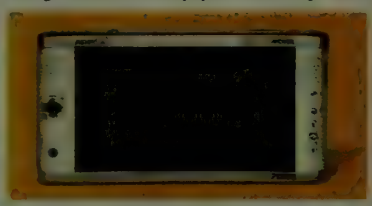
IN SOME WAYS the portable video-pla market today looks eerily similar to music market in the days before Ap jumped in. Despite research showing t consumers are interested in porta video for commutes, travel, show home videos, and entertaining their cl dren, analysts predict sales of just 1.2 n lion media players worldwide this y Many companies had hoped to mak big splash early on with players using M crosoft Corp.'s Portable Media Cen software only to see buyers turn up th noses at high prices and tiny screens t are still generally only 3.5 inches acr The biggest barriers to growth, analy say, have been lack of mainstream c tent, such as Hollywood movies and shows, and painfully slow downloa "There hasn't been a company like Ap entering the market and offering cont in one easy-to-find place," says In-S analyst Stephanie Guza.

Now, borrowing from Apple's winni formula, hardware companies are pair up with content providers. Earlier t year, EchoStar took a 25% stake in Arc Technology, a French company that some of the slickest products. Togetl they plan to start offering DISH Networ 11 million customers and new subscrib its PocketDish video player in three

Preemptive Strikes

Electronics makers are hoping their latest portable video players will leave any future Apple entry far behind

ZEN VISION
Holds up to 120 hours of video but has only a 3.7-inch display. **$499**



POCKETDISH AV700E
Features a big 7-inch screen, plus fast download capability. **$599**

SAMSUNG YH-99
The next generatic out in 2006, may boast a satellite T tuner. **$550**

ors, from $329 for a 2.2-inch screen to $599 for a 7-inch screen. They also believe they have solved the downloading problem. Movies that once took as long to download as they took to watch can now be transferred from a set-top box to a player in seven minutes. Meanwhile, Samsung is considering adding a satellite-television tuner to its YH-999 player for release in the U.S. next year. For its part, Creative is adding photo-card readers to its players and links to Web sites such as those of MTV Networks and CinemaNow Inc. Both firms have improved downloading speeds. Creative's player, the $499 Zen Vision, has a 3.7-inch screen; Samsung hasn't yet set its screen size.

For the market to really take off, though, portable-player makers probably will need to go further in creating easy-to-use one-stop shops that offer a wide array of video. And who better to do that than Apple, which already has brought music, short videos, and podcasts to its iTunes Music Store? Of course, that will happen only if Jobs changes his own tune—for now he continues to argue that demand simply isn't there. Many analysts believe Jobs will bring digital movie downloads to home PCs and even to the living room before tackling portable devices. Perhaps. But rivals are taking no chances. ■

–By Cliff Edwards in San Mateo, Calif.

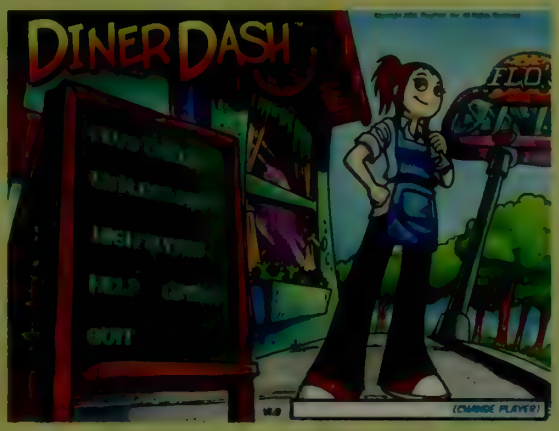
COMPUTER GAMES

Making a Play for All Those Non-Players

For 20 minutes every day, stock options administrator Christine Zwerling becomes Flo, a former desk jockey who is on her way to building a restaurant empire. Zwerling, 34, has become addicted to Diner Dash, a $20 downloadable game from publisher and Web site PlayFirst Inc. "I never would consider myself a gamer," she says. "Yet I do play games."

Zwerling has a lot of company: an estimated 56 million adults worldwide who may not care when the next Madden NFL Football is released but who still want a little game time. Call them the casual gamers: a set of folks loosely defined as those who have broadband but play less frequently—and who want less complex games—than the much smaller hard-core gaming crowd.

Suddenly, everyone from RealNetworks Inc. to Time Warner Inc. is eagerly pursuing these part-time players. In September, Yahoo! Inc. revamped its game portal to make it more attractive to casual gamers. And on Oct. 3, Time Warner subsidiary Turner Broadcasting System Inc. plans to launch a Web-based games channel called GameTap; a few weeks earlier, Time Warner took a $7.5 million stake in games publisher Glu Mobile. "Casual games attract more females and an older demographic," says CEO Greg Ballard of Glu Mobile. "They have a lot of money and not a lot of time."



MAKE-BELIEVE RESTAURATEUR Part-time gamers are a juicy market

On the face of it, the casual gaming market hardly looks like the best place to score big. Users typically get to try out casual games free of charge—which is not the case with games sold at retail. Then, if they like them, they can download the games from the Web to a PC or mobile device for anywhere from $2 to $20 apiece. Analysts say that only 2% of the people who check out casual games actually wind up buying them.

Despite those dismal numbers, however, growth is coming fast. From about $350 million today, revenues could grow to $1 billion by 2008, predicts JupiterResearch analyst Michael Garternberg. Much of that growth is expected to come from game-happy Asia. Fat margins help make this business an even better draw. Casual games are typically much simpler than the more realistic games favored by computer game addicts. As a result, they cost only about $50,000 to develop, compared with as much as $20 million for the games sold at retail. If a game hits big with just a fraction of the big group of casual gamers out there, the low overhead provided by Web distribution means that a company can rake in 90% margins with each sale, says JupiterResearch's Garternberg.

That prospect has many companies jockeying to establish a strong presence in hopes of grabbing a bigger share of the pie down the road. "We expect to see other major media companies enter the space relatively quickly as soon as they understand how to play," says Dennis Quinn, Turner's executive vice-president for business development.

Web portals are already setting up what they hope will be one-stop shops for casual gamers. Yahoo and Macromedia Inc.'s Shockwave, for instance, aggregate games from other sites such as PlayFirst and WildTangent Inc.

By doing so, they win twice over. Publishers say the large portals often demand 50% of every $1 a customer spends. And because Yahoo and others bring more customers to their sites, they can demand higher rates from advertisers trying to reach those customers.

Increased competition among the game industry heavyweights and small fry could have some unintended consequences. As with the shoot-'em-ups that are taking place in other parts of the games business, software development costs could skyrocket as rivals try to steal the limelight with hot new games, thus spoiling those juicy margins. But with the market expected to balloon to 80 million players by 2010, companies may soon be more addicted to casual games than the customers they're trying to reach.

–By Cliff Edwards in San Mateo, Calif.

THE STAT

80 MILLION

Projected number of casual gamers* worldwide by 2010, up from 56 million now

* Adults over 18 with broadband who play games at least occasionally

Data: Entertainment Software Assn

MANAGEMENT

LESS COULD BE MORE AT MICROSOFT

Going from seven units to three may reignite the entrepreneurial fires

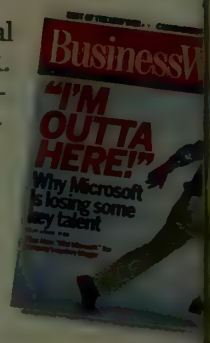
FOR THE LAST YEAR, AN anonymous Microsoft Corp. employee, dubbed Mini-Microsoft, has blasted the company's top brass on his Weblog for being out of touch. Mini, as he's known around the Redmond (Wash.) campus, has criticized everything from stifling bureaucracy that slows development to an unfair review process that pits co-workers against one another. But when Microsoft CEO Steven A. Ballmer unveiled a major reorganization on Sept. 20, Mini finally saw a bit of light in the darkness. "Thank goodness," Mini began in a post hours later. "I felt like we've at least been thrown a bone."

Give Microsoft credit for acknowledging the challenges, some of which were detailed in *BusinessWeek*'s Sept. 26, 2005, Cover Story. Just six days earlier, Ballmer had sat in an empty conference room at the Venetian hotel in Las Vegas and insisted that the software giant wasn't bogged down in bureaucracy. "We have the healthiest company in the world," he said.

But with the drastic streamlining of Microsoft's structure, Ballmer is clearly trying to improve its ability to vie against nimble upstarts such as Google Inc. and Salesforce.com Inc. He's collapsing the corporate structure from seven groups to three—Platform Products & Services, Business, and Entertainment & Devices—with a president to run each one. It's meant to help execs make decisions quickly and be held accountable for their strategy. "The establishment of these president positions reflects the critical importance I place upon having strong leadership in all three groups," Ballmer wrote in an e-mail to employees.

Sounds good on paper. But will the changes at the top trickle down to the rank and file? "It's good that they recognize the issue, but a reorg is only step one," says Jason Maynard, a Credit Suisse First Boston analyst. Microsoft still needs to find a way to compete against Web-based rivals that don't have the legacy PC business that can sometimes slow Microsoft down.

There's no question that Ballmer chose capable men to run the new divisions. All are sales and marketing vets who have previously worked for Ballmer. Microsoft's former global sales chief, Kevin R. Johnson, will run Platform Products & Services, along with Windows boss James E. Allchin, until Allchin retires at the end of next year. Jeffrey S. Raikes, who'll run the new Business division, is a 24-year Microsoft hand who now runs the $11 billion Information Worker group. Robert J. Bach, chief of the Entertainment & Devices division, most recently led the Xbox video game console business, a money-losing group that has nevertheless leapt over industry giant Nintendo Co. to the No. 2 spot behind Sony Corp.



LAST WEEK'S ISSU

"FEWER ROADBLOCKS"

BUT THE FOUR will have their work cut out changing a company with 60,000 employees. For one thing, fast-moving development teams have complained of being saddled with the problems of slower moving ones. The next version of Windows, dubbed Vista, for example, was hobbled by plans to include a new way to find and store files. When that initiative faltered, the entire project got sidetracked. In an e-mail to employees, Allchin wrote that he hopes Microsoft will have "fewer roadblocks" in product development.

Will the reorg help Microsoft trim its growing bureaucracy? To take advantage of its strengths as it attacks several markets, the company has instituted formal processes to coordinate those efforts. But that has often led to endless meetings that distract workers from developing products. Microsoft hopes to streamline that process, putting product groups that depend on similar technology under the same organization. The question, of course, is whether merging seven divisions into three will really trim the red tape. Microsoft says the new chiefs know how to get things done. At this point, it's hard to tell how much difference the reorg will make. But one thing is clear: The company is taking steps to manage its business better. ■

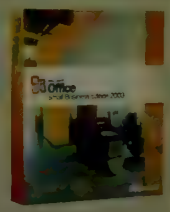
–By Jay Greene in Seattle

Remaking Microsoft

Each new division faces its own challenges

PLATFORM PRODUCTS & SERVICES
Annual sales: $24.4 billion
Chiefs Jim Allchin and Kevin Johnson need to make these operations more nimble. How? Maybe by getting the slow-moving Windows division to adopt some of the product-development mojo of new stablemate MSN.

BUSINESS
Annual sales: $11.8 billion
Jeff Raikes, the 24-year Microsoft vet who will run the new Business division, has a couple of key tasks. Business Solutions is still digesting two big acquisitions, while the Office franchise isn't growing as fast as it used to.



ENTERTAINMENT & DEVICES
Annual sales: $3.6 billion
Division boss Robbie Bach helped launch Xbox. Now he will have to make the game-machine profitable and turn other businesses, such as Windows Mobile and Microsoft TV, into meaningful revenue generators.

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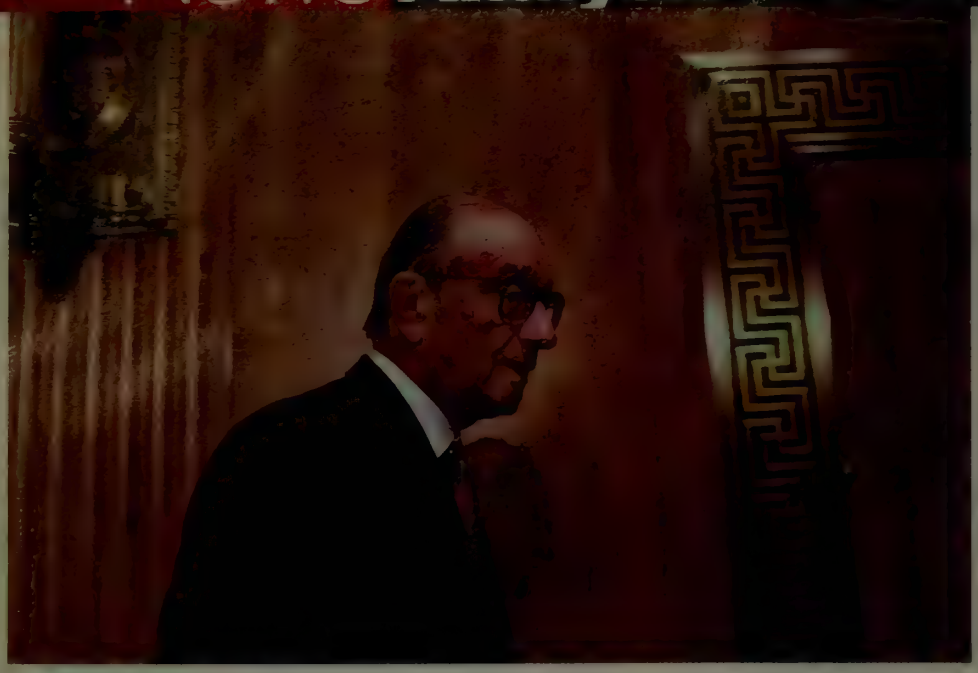


GREENSPAN Even he wonders how long the surge can last

THE ECONOMY

WORKERS MAY BE SLOWING TO A TROT

Productivity growth is not as robust—and that could mean more interest-rate hikes

WITH THE GULF crippled by Hurricane Katrina—and now threatened anew by Rita—it's no wonder that Wall Street is obsessing over how hurricane season will affect the economy and monetary policy. The havoc wrought by Katrina crimped economic growth by throwing millions of people out of jobs and destroying billions of dollars' worth of homes and other physical capital. It also pushed up inflation by sending energy prices skyrocketing.

While Federal Reserve policymakers too have been wrestling over the effects of Katrina, they've also been debating a more fundamental question that will affect the economy long after the hurricane's impact is gone: Is the underlying growth rate of productivity slowing? Some believe it has and point to sluggish business investment in efficiency-enhancing computers and other equipment to buttress their claim. Others are more upbeat and see scant sign of a slowdown.

The resolution of the debate has big implications for the economy and for Fed policy. Fading productivity growth lowers the "speed limit" for the economy—the rate at which it can grow on a sustained basis without sparking faster inflation. If underlying productivity growth really is slowing, that means that the Fed may have to follow up its Sept. 20 quarter-point rise in interest rates with a few more rate hikes if it wants to keep price pressures in check.

Productivity growth has slowed sharply over the past few years, dropping from a year-over-year rate of 5% in the fourth quarter of 2003 to 2.2% in the second quarter of this year. But such fluctuations are normal responses to the cyclical ebbs and flows of the economy. More important is the underlying rate of long-term productivity growth—what economists call the sustainable r But that's devilis difficult to disc through the gy tions of the econo

Fed Chairman Alan Greenspan among the first to recognize in the m 1990s that productivity growth was pi ing up on a long-term basis, despite wi spread skepticism inside and outside Fed. But recently, he's sounded a bit m cautious about how long the producti revolution can last.

What has prompted some Fed offici to begin rethinking productivity are vised economic data for 2002-2004. figures show that economic growth o that period was slightly slower than f estimated. But just as important, t also showed that capital investment both 2003 and 2004 was a lot lower t initially thought. The revisions h prompted some top Fed officials—m prominently, San Francisco Fed Presid Janet L. Yellen—to mark down their e mates of trend productivity growth.

ENERGY DRAG

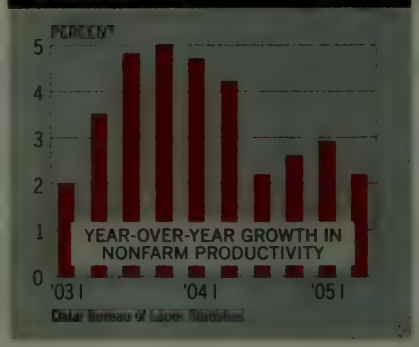
WHAT'S MORE, BUSINESS spending so this year hasn't picked up as strongl some Fed officials hoped. Excluding fense and aircraft, capital goods sh ments have fallen in five of the first se months of this year, according to the est data from the government.

The steep rise in energy costs—and likelihood that they'll stay high for a wh —also threatens to undermine produc ity growth by making existing facto less efficient, some Fed officials beli In certain cases, such as in the chem industry, companies have been force shut down plants cause it's become costly to run them.

In other ca they've diverted m ey that would h been spent on impr ing worker efficie and instead used i cut down on ene usage. While that duces their costs does little to b output. Dow Chem Co, for instance, is pouring money int effort to reduce its energy consumpt "We are constantly looking for projec says Gordon E. Slack, business directo Dow Chemical's energy business. " problem of high energy prices is n short-term one."

As execs across industries hatch si

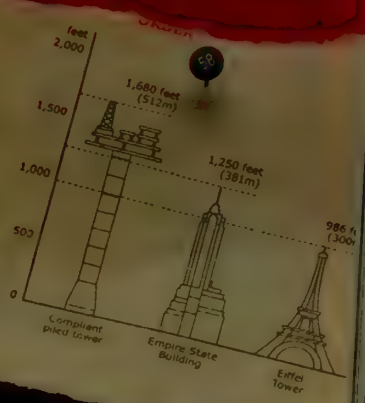
EASING UP



The world consumes two barrels of oil for every barrel discovered.

So is this something you should be worried about?

The world consumes 84 million barrels of oil a day.

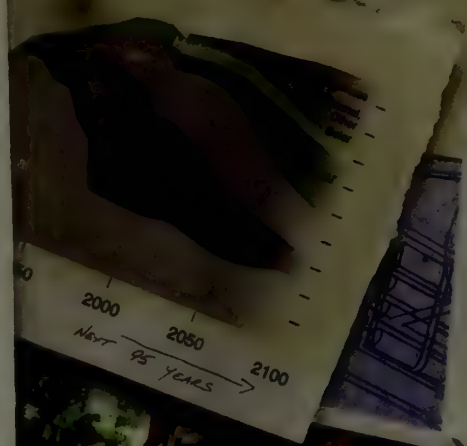


By 2030 the number of cars in the world will increase by 50%.

The fact is, the world has been finding less oil than it's been using for twenty years now. Not only has demand been soaring, but the oil we've been finding is coming from places that are tough to reach. At the same time, more of this newly discovered oil is of the type that requires a greater investment to refine. And because demand for this precious resource will grow, according to some, by over 40% by 2025, fueling the world's growing economic prosperity will take a lot more energy from every possible source.

The energy industry needs to get more from existing fields while continuing to search for new reserves. Automakers must continue to improve fuel efficiency and perfect hybrid vehicles. Technological improvements are needed so that wind, solar and hydrogen can be more viable parts of the energy equation. Governments need to create energy policies that promote economically and environmentally sound development. Consumers must demand, and be willing to pay for, some of these solutions, while practicing conservation efforts of their own.

Inaction is not an option. But if everyone works together, we can balance this equation. We're taking some of the steps needed to get started, but we need your help to get the rest of the way.



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lar plans, productivity gains could suffer. Some Fed officials now peg the underlying rate of productivity growth at about 2¼% vs. the 2½% or more they thought previously. That would put the economy's speed limit at something closer to 3%, rather than 3½%.

But not all economists are convinced productivity growth is slowing on a sustained basis. Some minimize the importance of outlays on technology, noting productivity growth held up through the tech spending bust at the start of this decade.

The steep rise in energy costs is another threat

They argue it's not technology spending alone that determines worker efficiency. It's how the workers make use of the equipment they're given. "While tech plays an important role in productivity growth, it's really the business process changes that drive it," says Martin N. Baily, who served as White House chief economist under President Bill Clinton. Baily, now with the Institute for International Economics think tank in Washington, pegs the trend growth of productivity at 2¾% to 3%.

CURB ON INFLATION

COMPETITIVE PRESSURES also play a key role in promoting productivity growth, according to this school of thought. An upcoming study on the automobile industry from consultants McKinsey & Co. makes just that point, noting it was competition from Japanese transplants that finally forced Detroit to improve efficiency. And such pressures are not about to go away anytime soon in an increasingly globalized economy.

As Greenspan and his colleagues have sought to manage the economy's vicissitudes over the past decade, they've been greatly aided by the strength of productivity. It allowed the economy to grow faster without pushing up inflation. Now, as the 79-year-old chairman prepares to step down early next year, some at the Federal Reserve are wondering whether the central bank's luck has run out. If so, the economy could face tougher times ahead. ■

–By Rich Miller in Washington, with Michael Arndt in Chicago

AFTER KATRINA

A CONSERVATIVE NEW DEA FOR THE GULF COAST

Bush's plan for relief mixes big spending with goals held dear by the Right. Will it work?

BILOXI The re effort will be biggest since War on Pover

AIR FORCE ONE FLEW toward the Hurricane Katrina disaster zone on Sept. 15, Mississippi Republican Senator Trent Lott was ushered into President George W. Bush's cabin. Nearby, top advisers, including Chief of Staff Andrew H. Card Jr., Counselor Dan Bartlett, and chief White House lobbyist Candida Wolff, were hashing out details of one of Bush's most important speeches, set for New Orleans' French Quarter that evening—a pledge to do "whatever it takes" to rebuild the ravaged region. Lott, whose Pascagoula home had been washed away, suggested three guiding principles for the address: Bush should acknowledge mistakes, show "passion and compassion" for the victims, and employ conservative ideas to revive the region's economy.

A few hours later in front of the cameras, Bush hit all the marks as he outlined the most ambitious and potentially costly domestic initiative since President Lyndon B. Johnson's War on Poverty. The Gulf reconstruction plan is a huge gamble for a President scrambling to recover from his Administration's chaotic response to the disaster. The scope of Bush's ringing pledge to rebuild the Gulf Coast, cost be damned, shocked fiscal conservatives in his party—especially as a second storm, Hurricane Rita, threatened to wreak still more destruction. Yet Bush's vision of stimulating business investm to lift thousands out of poverty is a cry from classic Washington-dire pump-priming. Instead, it is someth of a conservative New Deal, a radic rethought version of Big Governm that bends its spending to conserva goals: lower taxes, less regulation, m local control, and bootstrap capitalis

In crafting their aid package, B and key officials—political guru Rove, chief economic adviser Allan Hubbard, and domestic policy c Claude A. Allen—focused not only short-term political salve but also transformational ideas that will make Gulf region an economic laboratory the country. The result: a mix of busi tax breaks to spur reconstruction such Ownership Society concepts as ban homesteading, where Bush we give coastal residents title to more t 4,000 government-owned housing u in exchange for promises to improve properties with "sweat equity" and help of nonprofit groups.

Of course, the bulk of an estim $200 billion reconstruction tab wi spent on infrastructure. Bush

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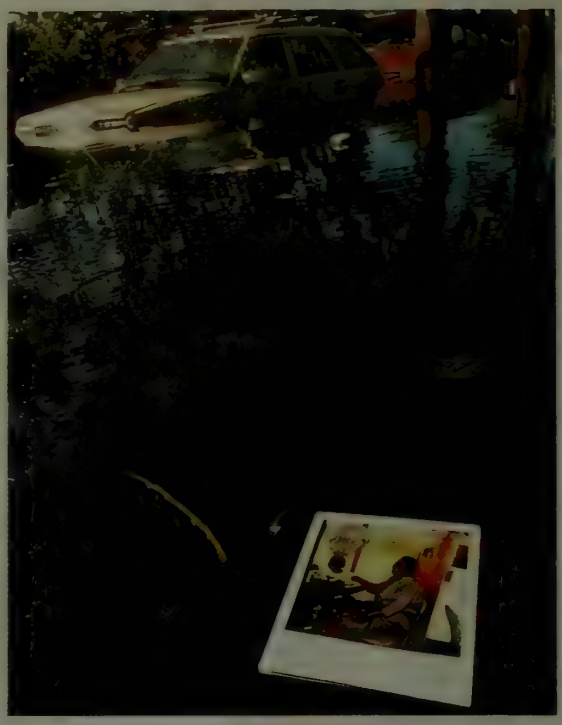
pledged that Washington will pick up almost all of the cost of repairing highways, sewers, levees, and waterways. Yet there, too, the President is applying a conservative twist, by seeking more local control over rebuilding priorities and by sending in SWAT teams of federal auditors to root out waste. To speed the work, he also waived a raft of labor and environmental rules.

"GO ZONE"

IN RESHAPING the region, the White House senses an opportunity to push conservative programs to the max. "Bush wants to try out ideas, under the color of an emergency, that he hasn't had success with so far," says Will Marshall III, president of the Progressive Policy Institute, a centrist think tank. Voucher-style aid, for instance, for all schools that take in students evacuated from the hurricane zone—including private schools—will stir strong opposition from teachers' unions and their Democratic allies.

Bush's other ideas, though, may go down a little easier with Dems. Take the plan for a "Gulf Opportunity (GO) Zone." It builds on the concept of tax-favored enterprise zones, which try to entice businesses to invest in depressed areas by offering preferential rates on local property levies and state corporate taxes. Bush is proposing the largest enterprise zone ever—covering swaths of three states—and the first to offer relief from federal taxes. Businesses could take accelerated depreciation for investments in equipment and structures, with small companies deducting up to $200,000 a year and larger companies writing off 50% of investments immediately. The White House wants the breaks to last only through 2007, but Big Business will fight to extend them.



NEW ORLEANS Bush hopes tax breaks will spur rebuilding

Will the GO zone induce enough go-getters to get the Gulf economy humming? Local enterprise zones have a decidedly mixed record. They fare best at creating new businesses and jobs in suburban areas. But in remote or depressed locales where companies are wary, "taxes are too small a piece of corporate finance to make much of a difference," says Donald Hirasuna, an analyst for the Minnesota House of Representatives and author of a study of enterprise zone performance.

But relief from the federal corporate tax, now at 35%, offers a bigger incentive than local tax breaks provide. What's more, the GO Zone is designed mainly to bring companies back to their old locations—"an efficient way to help subsidize rebuilding through the tax code," says Peter S. Fisher, professor of urban planning at the Unive ty of Iowa. (compromis Bush may h to accept: s plementing business-tax bre for new equipment with credits hiring. "More resources shoul targeted on the household lev says Michael W. Sherraden, pro sor of social development at Wa ington University in St. Louis.

Another key reconstruct idea is Bush's proposed Ur Homesteading Act. The goal: ing government-owned lots foreclosed apartments to l income owners who promis improve them, just as post-C War homesteaders turned Great Plains prairie into farmla Trouble is, the small scale of program—4,000 homes so far cluding just 1,000 units scatte across New Orleans—won't solve problems of a half-million displac mostly poor, residents.

Pouring big bucks into disaster re is no doubt good politics as TV image human suffering bring the dam home. But shaping that spending meet conservative goals will be m harder, especially for a President at nadir of his popularity. Yet Bush has tle choice. With his Administration reeling from the fallout of a botc response to Katrina, he needs to something big to regain moment That's why the fate of Gulf reconst tion and the Bush legacy are now i tricably linked. ■

–By Richard S. Dunham, Mike Namee, and Eamon Javers, with Lee V czak and Paul Magnusson, in Washing

"Whatever **It Takes**"

Katrina's devastation gives President Bush a chance to push his ownership agenda:

GULF OPPORTUNITY ZONE
Business would get faster write-offs for equipment and structures installed in the hurricane zone through 2007. Estimated cost: $2 billion.
CONSERVATIVE TWIST: Encourages investment through tax breaks.

URBAN HOMESTEAD ACT
Feds would turn over some 4,000 housing units to residents who make improvements and stay. Estimated cost: Less than $1 billion.
CONSERVATIVE TWIST: Promotes home ownership.

WORKER RECOVERY ACCOUNTS
Workers who return to the hurricane zone will get $5,000 for job training and relocation. Estimated cost: Less than $1 billion.
CONSERVATIVE TWIST: Provides funds to individuals, not states.

EDUCATION AID
Washington will reimburse schools up to $7,500 per evacuated child and provide aid for new charter and private schools in the hurricane zone. Estimated cost: $2 billion.
CONSERVATIVE TWIST: Lets parents choose public or private school.

INFRASTRUCTU SPENDING
The Feds will pay most costs for rebuilding highways and other facilities. Estimated cost: Most of Katrina's $200 billion federal price tag.
CONSERVATIVE TWIST Promises more local control over funding.

Even the most sophisticated nonitoring systems are only as adept s those who are managing them."

– Ira A. Lipman
New York

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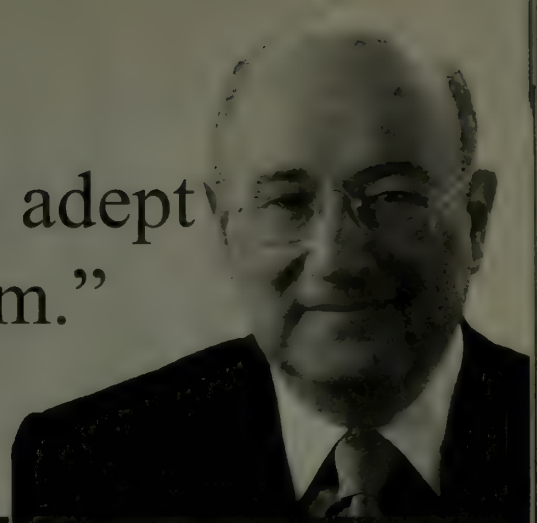

Ira A. Lipman
Chairman

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AS A NATION, we are increasing our reliance on new technologies in the war on terror. Even the most sophisticated nitoring systems are only as adept as those o are managing them. Too often, it is the nan side of security that is overlooked. eady, billions have been spent and lost on nologies aimed at countering today's threats nly later found to be ineffective or unreliable.

Investments in sophisticated technology st be augmented by the selection of people o can respond to security threats quickly and ctively. Society looks to the security industry protection, and we have a responsibility to cate the public about the necessity for stant vigilance. At the same time, the rity industry faces an opportunity to grow to elevate the reputation of the profession.

- Ira A. Lipman
Founder and Chairman

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Being serious about security is not just ut employing more security officers or ing more technological equipment. It is about oaching security in a different, smarter way. about knowing the backgrounds of one's loyees and on-site contractors. It is about ring that the one person accountable for rity also purchases security. It is about sidering the realm of possible threats and eloping proactive solutions. It is about ning vendor partnerships to give others a e in ensuring that all that can be done is e. It is about a commitment to total quality.

Do you compromise on security when it es to protecting your family? Experts know ***the more you do, the safer you are.*** kplace security is no different; only the es are much greater. A large corporation is an extended family living in a huge hborhood: the chance of something going ng somewhere increases with scale and there more lives and livelihoods at risk.

Not all organizations think about security in terms of its total cost—at their peril. Some corporate budgets measure the dollars spent on security personnel and equipment but ignore the costs of crime and terror—the human tragedy, the liability expenses, the legal fees, the public relations and crisis management costs, the increased insurance premiums, the lost revenue from business interruption, the shaken confidence of customers and shareholders, the devastation in employee morale. Consider one example: A terminated employee, heavily armed, gains unauthorized entry past a new and inexperienced security officer. A single mistake, and several minutes later, lives are lost. Just one such tragic incident can jeopardize the future survival of an entire organization.

When companies view security services as a commodity, that is what they get. Some purchasing departments often only look at the unit cost, selecting the lowest bidder. Many service providers, however, fail to include additional costs, such as health insurance, vacations and even training, in their rates—which the customer may not discover until the invoicing starts. Other companies compete by minimizing their investment in wages, training and employee screening. Transient hourly employees treat their jobs in a perfunctory way. With limited authority, security managers cannot invest in quality or innovation. And yet if a serious incident occurs, they take the blame for failing to bring in a quality provider. This vicious circle detracts from buying the necessary value and focusing on what truly counts in security—results.

No entity can be entirely immune from crime and terrorism. When organizations commit time and resources to an urgent focus on security, however, they can minimize risk and create tangible value. A thoughtful security infrastructure supported by dedicated, energetic employees offers a shield against attack and often surpasses the traditional call of duty: responding to an accident on the shop floor and saving an employee's life or detecting a mechanical malfunction that could lead to a plant shutdown. A strong security program also acts as a deterrent. According to reports published in a leading national newspaper, a murderous terrorist cased a sensitive public facility in California and found the Guardsmark security to be so tight that he selected different targets, shooting six people and killing one. The wounded included three children.

Whatever concerns our clients face—from routine loss prevention investigations to dealing with kidnappings and assassinations in distant lands—our men and women stand ready with the wisdom of experience, the ability to manage uncertainty, and an intricate network of valuable relationships. These crisis-resolution skills give our clients the confidence that their security provider can respond to any emergency anywhere at a moment's notice.

Increasing emergency preparedness is essential to minimizing casualties. The ability of the United States to strike back with swift, devastating force does not deter agents of terror. Consequently, local governments must receive assistance to prepare for attack and to improve the technological capabilities of our emergency response agencies. Similarly, every organization must not only strengthen its defenses to prevent an attack, but it must also prepare to manage the aftermath of a successful assault by training on-site emergency responders and developing partnerships with firefighters, police and medical professionals. Securing a facility so that an attack will either fail outright or produce minimally disruptive consequences at best will significantly decrease the likelihood of a future strike.

The world has changed. Complacency has never been wise, but at this time of increasing uncertainty, it has become outright dangerous and irresponsible. At Guardsmark, we realize that each of our employees is the critical ingredient in securing some facility somewhere. Who that person is, what that person thinks and how that person reacts may make the difference between calm and calamity. That is why we are committed to excellence in management, to continuous innovation, to organizational ethics and diversity, and to an unyielding focus on the customer. It all has to do with being serious about security. That is our mission. And we believe that is the mission that you need. ***The time for urgency is now℠.***

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EDITED BY MONICA GAGNIER

HEADLINER

PAMELA THOMAS-GRAHAM

A CHANGE OF WARDROBE

She must love a challenge. After struggling to reverse a ratings decline at CNBC when the dot-com bubble burst, Pamela Thomas-Graham is leaving the world of TV business news for fashion. Thomas-Graham, 42, will start work as a group president at Liz Claiborne on Oct. 10. She has to pump up brands like Liz Claiborne and Emma James at a time when department stores are reeling from mergers and increased competition.

While selling women's clothing to department stores may seem miles away from managing a news operation, Liz Claiborne Executive Vice-President Trudy Sullivan notes that the company has hired outside the industry before. "We're excited to have someone with fresh eyes," says Sullivan. Thomas-Graham became CNBC's chairman in February after relinquishing the role of president and CEO. Liz Claiborne isn't Thomas-Graham's only new corporate gig: On Sept. 21, Clorox announced that she joined its board of directors.

– Diane Brady

GOLDEN DAYS AT GOLDMAN

The Masters of the Universe are walking tall at **Goldman Sachs**. True, some of the credit for the brokerage's gangbuster third-quarter earnings of $1.62 billion—an 84% rise over last year—goes to its investment banking division. The unit contributed its best quarterly showing in four years. Even asset management chipped in with a 23% revenue gain. But the real lucre came from trading and principal investments, where net revenue soared 88%, to $5.06 billion. Goldman is clearly thinking big, announcing a plan to buy back 60 million shares for an estimated $7.1 billion—the largest share repurchase in Wall Street history.

KOZLOWSKI'S COMEUPPANCE

Former **Tyco International** CEO Dennis Kozlowski, once one of the highest-paid CEOs in history, now faces the prospect of working for less than the minimum wage in a New York state prison. Kozlowski and former Tyco Chief Financial Officer Mark Swartz each received sentences of 8 to 25 years on Sept. 19 for looting over $150 million in the dealmaking frenzy that made Tyco one of the bull market's hottest stocks. The judge also ordered Kozlowski to pay $167 million in fines and restitution and Swartz to pay more than $70 million. Both were jailed on Sept. 19, but they are seeking release on bail while they appeal.

A RETURN FOR IMPLANTS?

The Food & Drug Administration has notified **Inamed** that its controversial silicone gel breast implants may be approved if certain conditions are met. The agency sent a similar letter to rival implant maker **Mentor** in July. In April an FDA advisory panel voted that Inamed's devices should be kept off the market because they are potentially unsafe. The FDA says Inamed has since addressed undisclosed safety concerns and agreed to take its riskiest implant off the market. Even if both companies meet the FDA's requirements, there is still no guarantee the agency will approve the implants. Other than for women who have had mastectomies, the implants were banned in 1992 on concerns—later proven unfounded—that they caused autoimmune diseases.

LILLY'S MAN OF SCIENCE

During its 129-year history, **Eli Lilly** has been run by CEOs with backgrounds in marketing, finance, and administration. Soon it may have its first CEO trained as a scientist. Lilly has promoted John Lechleiter, 52, to president and chief operating officer, effective Oct. 1. Lechleiter, who joined Lilly in 1979 as an organic chemist, most recently was executive vice-president of pharmaceutical operations. Chairman and CEO Sidney Taurel, 56, hasn't announced plans to retire, but he's expected to leave in the next few years. As COO, Lechleiter says his priority is to pump up sales. Although Lilly has launched a record nine drugs in the past four years, most have fallen short of expectations.

ET CETERA...

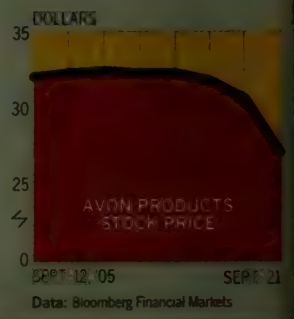
>> **Ford Motor** will increase its hybrid output tenfold, to 250,000 vehicles, by 2010.

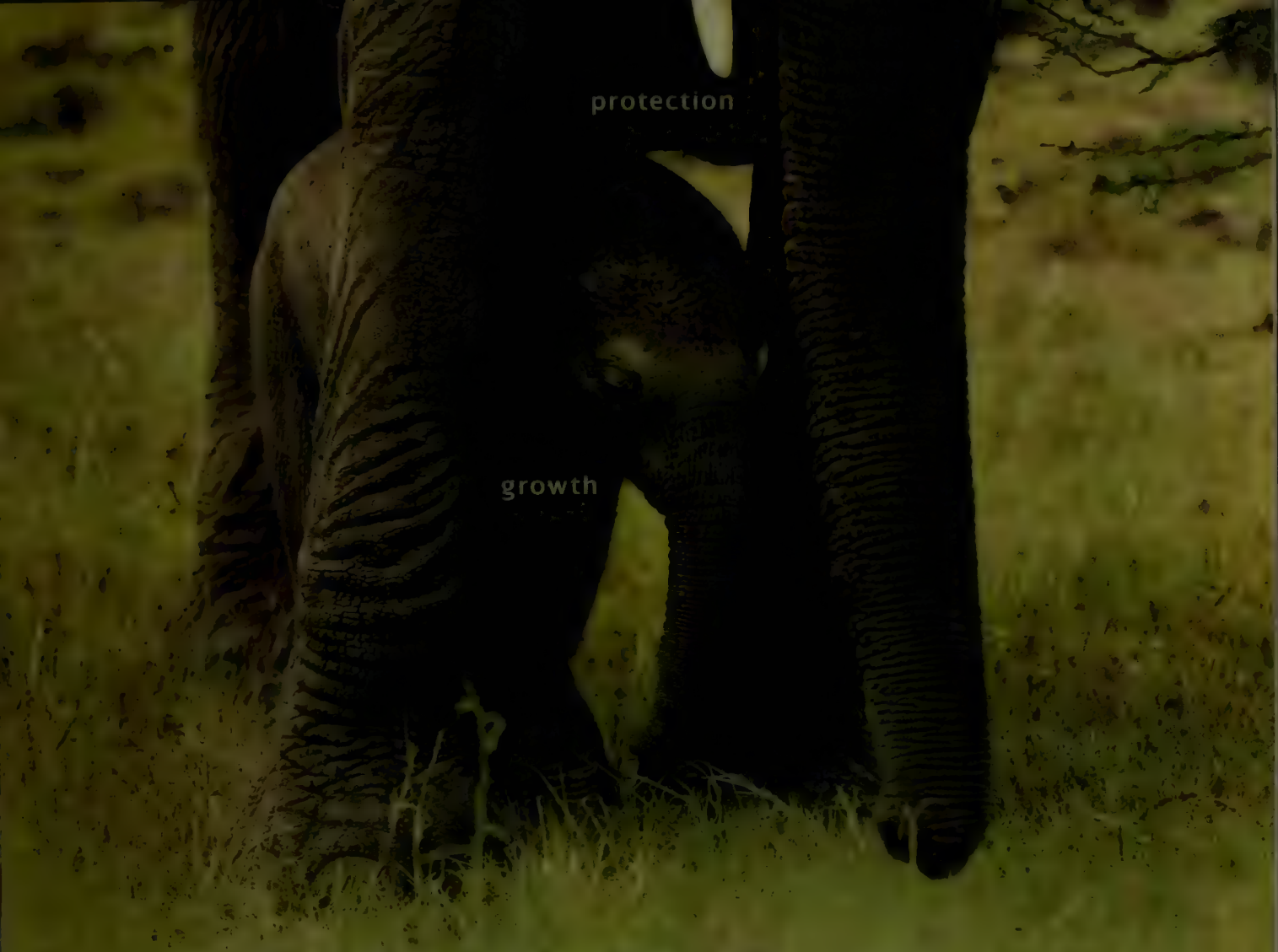
>> **Nike** reported a 32% jump in first-quarter profits on an 8% sales gain.

>> Kirk Kerkorian is hiking his stake in **General Motors** to 9.9%, from 9.3%, and may seek a board seat.

CLOSING BELL

Shares of Avon Products, off 40% from their February high, took an ugly 11.8% dive on Sept. 21, to $27. Avon cut its earnings forecast by 15%, citing Katrina, weakness in China, and shortfalls in onetime strongholds like Eastern Europe and Latin America.





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DITED BY LEE WALCZAK

Energy: Congress May Be Jolted Into Action

TER YEARS OF PARTISAN WRANGLING, Congress finally mustered e will to pass a $14.5 billion national energy bill in August. ouble is, the legislation failed to tackle the most pressing prob-ms—the double whammy of strained production capacity and sing oil and gasoline consumption—that have sent prices to ord levels. Those deficiencies were laid e by the devastation wrought by Hurri-e Katrina. And now prices are spiking in in anticipation of additional destruc-n from Hurricane Rita. With energy ts clobbering household budgets, voters clamoring for real action from Con-ss. "Energy is back on the agenda, big e," says House Energy & Commerce mmittee Chairman Joe Barton (R-Tex.). Predictably, those on both sides of the rgy issue are pushing pet prescriptions. nservatives like Barton want the O.K. to ld more refineries and drill for oil off-re and in the Arctic National Wildlife fuge (ANWR). Environmentalists see an portunity to throttle back nsumption with measures stricter energy efficiency es and more stringent porate average fuel econ-y (CAFE) standards for os. The enormity of the sis may keep the postur-to a minimum, but "it's a 50 chance that they can it done this year," says top lobbyist.

f Energy Bill II does terialize, look for these elements:

Building Refineries. Barton ushing a measure that matically speeds up the ng and approval process. It also would ignate construction corridors where v facilities could be built quickly, in-ding surplus military facilities. While s fast-track idea will be opposed by envi-mentalists, even many Dems agree that rina has shown how badly the nation ds to ramp up refining capability.

More Drilling. According to a Sept. 8-11 v Research Center poll, 57% of Ameri-s say it's more important to develop new energy sources than to protect the environment, a jump of eight percentage points since March. That shift, along with the heightened sense of vulnerability, has emboldened business interests such as the National Association of Manufacturers to call for more development of the Outer Continental Shelf. "It is a stretch to look for any good news in Hurricane Katrina, but perhaps we can learn from it," says NAM President John Engler. Expect a new push to open up ANWR and build an Alaskan gas pipeline.

Conservation and Alternative Energy. Traditionally, Republicans have opposed efforts to reduce energy use through federal mandates. But post-hurricane politics are forcing a change. Senate Energy & Natural Resources Committee Chairman Pete Domenici (R-N.M.) is cautiously embracing the idea of raising CAFE standards. And he's considering other steps, such as more tax rebates for fuel-efficient products and even reduced speed limits. Meantime, Dems see an opportunity to slip in additional incentives for alternative energy, such as requiring utilities to generate more electricity from renewables.

AFTER THE STORM Katrina added urgency to the energy debate

Passing a new energy bill in the compressed calendar confronting Congress this fall will be a challenge, especially since many of these measures were too controversial to be included in the legislation Bush just signed. And each will be fiercely opposed by special-interest lobbies and the not-in-my-backyard set. But Katrina and Rita may have changed politics-as-usual enough for Congress to pass an energy bill that makes a difference. ■

–By Eamon Javers, with John Carey

CAPITAL WRAPUP

TORT REFORM'S NEW FOE ON THE RIGHT

BUSINESS LONG HAS relied on its GOP allies to push its tort reform agenda, but cracks might be forming in that once-reliable foundation of support. **Ken Connor,** former head of the conservative Family Research Council and the lawyer who represented Florida Governor Jeb Bush in his bid to keep Terri Schiavo on life support, has taken up a new cause—tort reform. He's against it.

Connor, a trial lawyer at Wilkes & McHugh, is chairman of the Center for a Just Society, a fledgling Washington-based nonprofit. Among its goals: teaching fellow social conservatives that continuing effort by business to lessen its exposure to legal liability violates fundamental Republican principles of states' rights and personal accountability. "Tort reform is affirmative action for wrongdoers," Connor says.

THE PENTAGON DEAL THAT WON'T DIE

AFTER SCANDAL torpedoed Air Force plans to lease Boeing refueling tankers, you would think the flyboys would tread lightly. Guess again. In late August the Air Force requested info from contractors about a possible tanker fleet—before it had completed an analysis of its options demanded by **Senator John McCain (R-Ariz.),** who opposed the earlier deal.

That deal collapsed after a Boeing exec offered a job to an Air Force official working on the contract. Both went to jail. When McCain learned that the Air Force had jumped the gun, he demanded that the Pentagon rescind the request until the analysis is done. A top Pentagon official pulled the plug the next day.

CHINA

REACTORS? WE'LL TAKE THIRTY, PLEASE

Westinghouse, GE, and their nuclear rivals are chasing $50 billion in Chinese power-plant deals

POWER TO THE PEOPLE'S Republic! That could easily be the slogan of the nuclear power executives winging their way to Beijing these days to pitch next-generation reactor designs, downplay rivals' plans, and woo the Communist Party leadership. President Hu Jintao's government is committed to spending $50 billion to increase nuclear power generation capacity from 8.7 million kilowatts today to 40 million kilowatts by 2020. That's one of the largest buildouts in the industry's history. And by the time that $50 billion is spent, some 30 new reactors will be pumping power to China's most important cities, in addition to the nine operating today. Most are to be built along a rapidly industrializing coastal arc stretching from Shandong province in the northeast to Guangdong province in the south.

The sheer scale of the ramp-up has global energy players salivating, including such giants as France's Areva Group, the world's biggest nuclear engineering firm with $13.5 billion in sales, Westinghouse Electric, Mitsubishi Heavy Industries, and Russia's Atomstroyexport. General Electric Co.'s nuclear division is in the chase as well, while Paris-based Alstom and Germany's Siemens hope to cash in on contracts for reactor turbines and control and instrumentation systems.

The first contract up for grabs, valued at roughly $8 billion, is for four reactors in southern China: two in Zhejiang province's Sanmen and another pair in Yangjiang in Guangdong province. Beijing is expected to make its decision in October, and right now it looks like a two-way race between Areva and a consortium led by Westinghouse, which is owned by British Nuclear Fuels. It has been years since an order for a reactor came from a U.S. utility, and even orders from nuke-friendly countries such as France have been skimpy. "It's pretty critical," says Westinghouse CEO Stephen R. Tritch. "If you are not selected early, you could be locked out of the market."

BROWNOUTS AND SMOG

IT IS NO SECRET that China needs a massive infusion of new energy to keep the juice flowing to its manufacturing sector. Electricity brownouts are a regular feature of life in Shanghai and Guangzhou. And nuclear power only kicked in about 2% of China's total power supply last year, vs. 30% in Japan. Even so, nuclear plants are just one part of a much larger Chinese push to expand and upgrade the country's power grid.

In fact, demand for power is growing so fast that even if China builds all the nuclear plants on the drawing board, industry officials say atomic energy will account for only about 4% of total electricity generation. That's because t country is also building dozens of co ventional power plants. But Chi wants to move away from the high-s fur coal-fired plants blamed for world-class smog and acid rain woes goal that increases the value of nucle power. "Nuclear is clean and enviro mentally sound," says Wu Zongxin, professor at the Institute of Nuclear a New Energy Technology at Beijin based Tsinghua University.

Areva and Westinghouse were thrill when China opted for their type of pr surized water reactors in the current co tract bidding. In doing so, the Chine ruled out rival technology such as GE boiling water reactors and the heavy w ter plants sold by Atomic Energy Canada, two of which are already oper ing in China. GE and AEC say they ho to win over the Chinese in future pla orders. "We have been asking if we c bid, but unfortunately they want pre surized water reactors," says An White, president & CEO of GE Energy Wilmington (N.C.)-based nuclear bu ness. "China should mo to a two-technology mo el, like other countries."

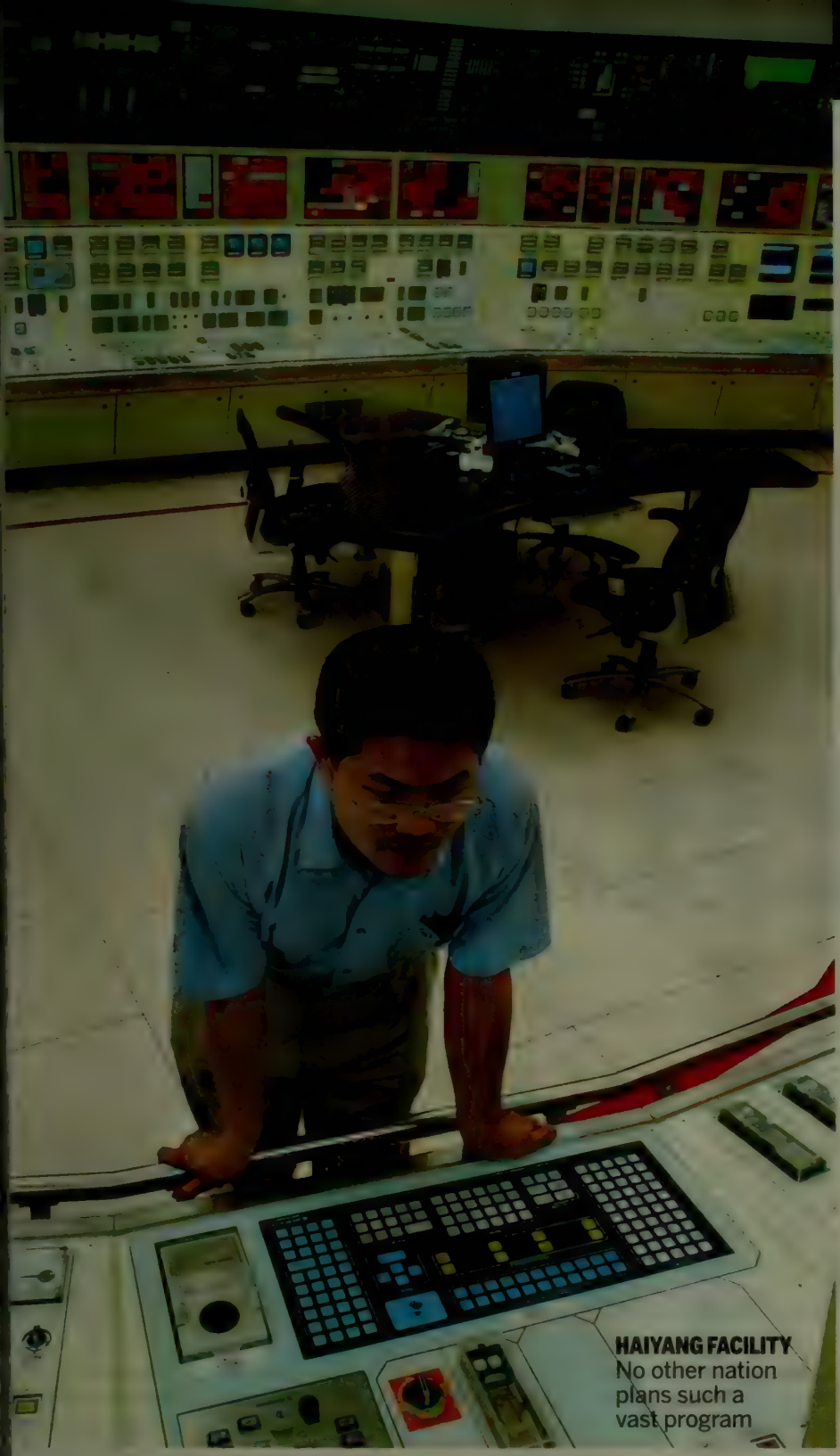
Yet Beijing is extracti a hefty concession fr the bidders by insisting massive transfers of n clear knowhow to lo partners. Both Areva a Westinghouse have co mitted to sharing th technology with the Ch nese to clinch deals. Chi is following a well-wo path: Japan, South Kor

Radioactivity

These companies are vying for Chinese reactor contracts

COMPANY	COUNTRY	TYPE OF REACTOR
Westinghouse	U.S./BRITAIN	Pressurized water
General Electric	U.S.	Boiling water
Areva Group	FRANCE	Pressurized water
Atomstroyexport	RUSSIA	Pressurized water
Atomic Energy	CANADA	Heavy water
Mitsubishi Heavy	JAPAN	Pressurized water

Data: BusinessWeek



HAIYANG FACILITY No other nation plans such a vast program

even France used technology pro-
d by GE and Westinghouse to build
r own nuclear industries. "If they are
rested in becoming totally self-suffi-
t, we will help them do so," says CEO
ch. "We are always inventing better
nology." The pressurized water re-
r Westinghouse wants to sell to
na is its new AP1000, which the com-
y advertises as much safer than the
Os-era reactors that dominate in Chi-
nd elsewhere.

he French also have pulled out all the
s to snag contracts. Areva already has
Chinese reactors up and running, and it has won points for providing technical assistance for the construction of a pair of Chinese-designed reactors that came online in 2002 and 2004. The company's latest pressurized water reactor has 1,700 MW of capacity per unit, vs. 1,000 for the proposed Westinghouse reactor. "We have a product that is quite advanced," says Arnaud de Bourayne, head of China operations for Areva.

Westinghouse's sales job has been complicated by a decision earlier this year by parent British Nuclear Fuels to exit the power plant business and sell Westinghouse. Rivals think this uncertainty could taint its bid. Another issue: U.S. congressional opposition to extending loans and loan guarantees from the U.S. Export-Import Bank. One reason is that Westinghouse, though based in Monroeville, Pa., is British-owned and will probably be sold to another foreign outfit, so critics say it doesn't deserve help from U.S. taxpayers.

THE POLITICS OF POWER

AN APPROPRIATIONS BILL passed by the House of Representatives removed Ex-Im Bank financing authorization, but Westinghouse is hopeful the Senate will restore it in upcoming conference committee meetings. The company, which has the Administration's support, points out that Westinghouse still employs 5,000 workers in the U.S. To bolster their case, company officials indicate that the lack of such financing may be a deal-breaker. And fat orders for nuclear plants could help ease the U.S. trade imbalance with China.

The other big potential player is Japan's Mitsubishi Heavy Industries, which already supplies the Chinese with coal- and gas-fired plants. Mitsubishi is a longtime partner of Westinghouse and may even buy the company from the British. "Nuclear reactors are becoming a core business," says President Kazuo Tsukuda. "We need the Westinghouse brand to grow." Whoever wins this first round, count on foreign energy executives' mad dash to China to continue for many years to come. ■

–By Brian Bremner in Hong Kong and Chester Dawson in New York, with Diane Brady in New York, Joseph Weber in Chicago, and Carol Matlack in Paris

PHOTOGRAPH BY REINHARD KRAUSE/REUTERS PHOTO ARCHIVE; MAP BY LAUREL DAUNIS-ALLEN/BW

NO MANDATE Merkel failed to rally public support for her pro-business agenda

GERMANY

IMPASSE IN BERLIN: WILL IT KILL REFORM?

The election brought a stalemate. Now, Germany Inc. warns of the consequences

ON SEPT. 18, BERLIN residents flocked to the gardens and parks that line the Spree river to bask in the warm glow of a late summer day. As the first results in the national election streamed in, several hundred watched a giant video screen set up outside the Reichstag. Some even applauded when it became clear that center-right challenger Angela Merkel and her Christian Democratic Union (CDU) had fallen short of a big victory—and that Germany would not see a major policy shift. "I'm happy," said Wolfgang Leopold, a 55-year old Göttingen resident, adding: "Merkel did not cut a good figure."

Germany Inc. saw things differently, to say the least. Business had fervently hoped for a reform-oriented government led by Merkel. Instead, in a vivid illustration of the gap between the management class and the German people, the nation got no government at all. Neither of the main parties, the CDU and Chancellor Gerhard Schröder's center-left Social Democratic Party (SPD), won enough votes to rule with their usual partners. At best, a "grand coalition" of the big parties will make modest progress on reforms. At worst, there will be no progress at all.

BIG LAYOFFS

A NEW GOVERNMENT might have inspired German companies to invest again in expansion and jobs at home. A resulting decline in unemployment, now at 11.4%, might in turn have inspired consumers to spe more. Such a fre beginning wo have been an o portunity not j for Germany but for all of the euro zo which is expected to grow just 1.2% t year. "It's extremely important for Euro to get back on track, and for that to ha pen, Germany has to get back on trac says former U.S. Ambassador John Kornblum, chairman of the German u of investment bank Lazard.

Now, German industry is warning consequences if the reform proc grinds to a halt. Gildemeister, a maker precision lathes based in the northw German city of Bielefeld, reported t dozens of customers postponed ord for weeks to see what kind of gove ment emerges.

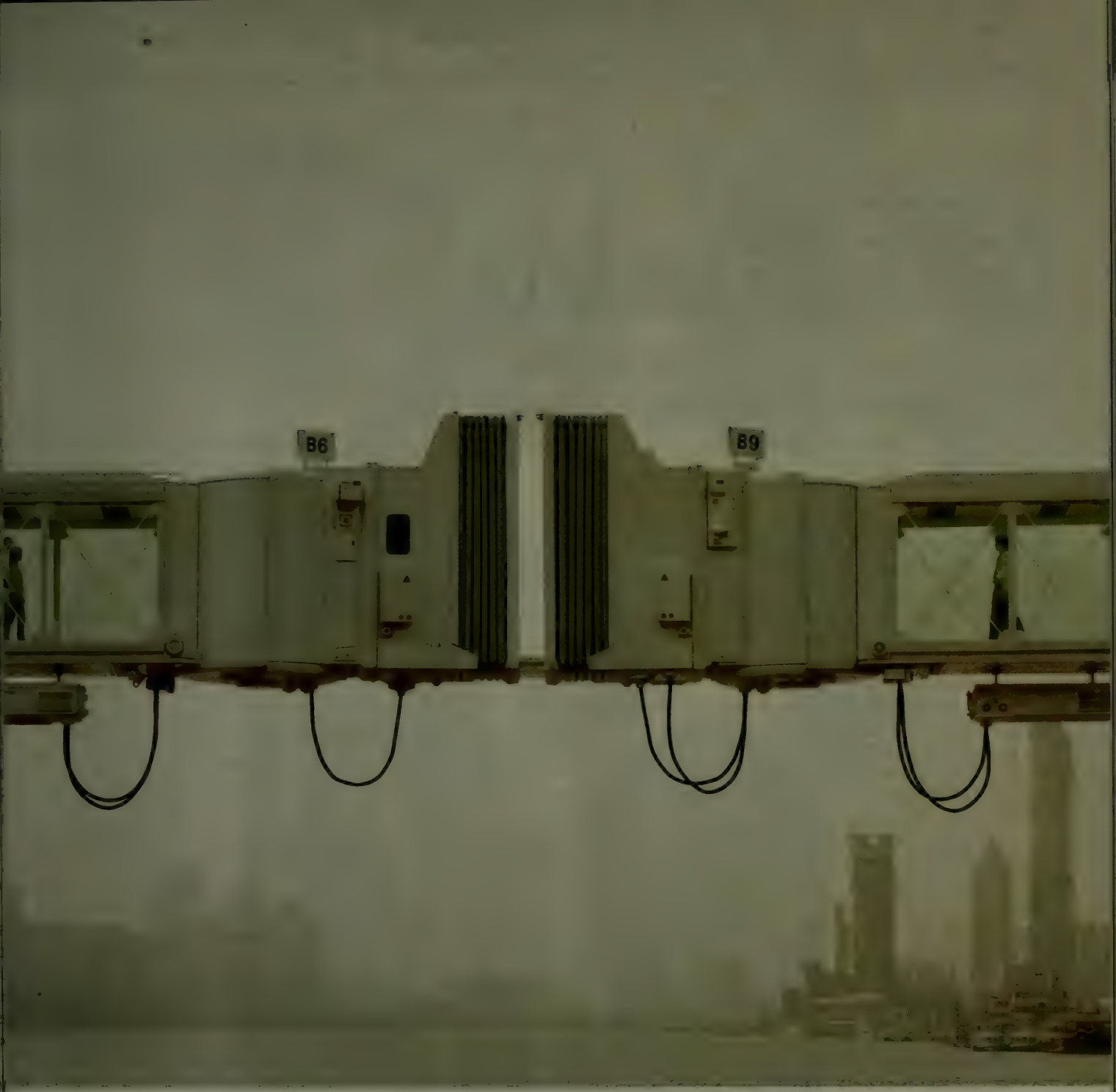
Meanwhile, German companies keep restructuring. Already, many h opted out of the employers' associati that negotiate industrywide wage agr ments with unions. Although the offi workweek for metalworkers is 35 ho many companies have cut deals to institute a 40-hour week. Also, Germ businesses are taking advantage of e access to low-wage countries such as S vakia and Poland. Half of all compar with more than 200 employees plan to invest abroad this year, according the Munich-based IFO Institute for E nomic Research.

In what seemed like more than ju coincidence, giant Siemens chose the after the election to announce 2,400 offs in Germany at its troubled Busin Services unit. Siemens CEO Klaus Kl feld denied that the timing was politi But, speaking on a conference call, added: "Those of us exposed to glo competition every day know very that we can't afford to stand still."

Some political observers are pinn their hopes on a grand coalition. prospects for vigorous reform, particu ly of labor rules that make offs difficult and discour hiring, look dim. "Someth will happen, but probably enough," says Martin Ko macher, head of Credit Su First Boston in Germany. T is not what the world expect Germany, adds Mani Diederichs, owner of Dirost a foundry in the northwest of Remscheid: "It's like I used to be." ■

–By Jack Ewing in Frank with Gail Edmondson in Be

THE GERMAN DILEMMA



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A LOPSIDED ECONOMIC MIRACLE

Chile's growth is strong, but inequality and joblessness remain stubbornly high

FOR VISITORS WHO ARRIVE at Santiago's world-class international airport and speed along a new toll highway to reach downtown, the city is one of Latin America's more impressive capitals. But Ana Lamilla, a 53-year-old housewife on the outskirts of Santiago, has a different view. Her husband makes less than $200 a month selling fruit from a pushcart. Two of their sons hold minimum-wage jobs, but a third sells metal scraps from dumps. The family can't afford to move out of their wooden shanty. "The world thinks we Chileans are the 'jaguars,' like the Asian tigers," she says. "But I don't feel like a jaguar."

Neither do a lot of other Chileans. It has been 30 years since the launch of the Chilean economic miracle, when General Augusto Pinochet's government, on the advice of economists trained at the University of Chicago, toppled barriers to trade and investment and privatized vital services, including telecoms, electricity, and later the pension system. That made Chile a hot market—and ushered in the era of the "Washington consensus," the doctrine that free markets could work their magic anywhere.

But now, as voters in this nation of 16 million gear up for a presidential election in December, some, like Lamilla, say they've missed out on the miracle. Consensus is building that the much-lauded Chilean model needs work. Foreign investment has leveled off. The poverty rate has been halved since 1990, but it stands at 18%. "Chileans realize they are much better off than neighboring countries," says Roberto Méndez, who heads Adimark, a Santiago market research firm. "But they feel that now it's time all Chileans benefit."

For all its achievements, Chile's economy remains dependent on natural resources. While its cabernet and salm have achieved international success, co per alone still accounts for 46% of all e ports. But jobs in commodity industri are limited, and service industries have developed enough to make up the ga Even with growth of 6% to 6.5% this ye unemployment is lodged at 8.6%. Rig labor laws that make part-time jo scarce are partly to blame. But employe also cite a skills deficit. Spending on ec cation, at 4.2% of gross domestic produ lags behind that of countries li Malaysia, which spends 8.1%. "O politicians want Chile to be a trade a services platform, but how can we be th with our poor schooling and witho good English skills?" asks Ricardo Cla chairman of Compañí a Sudamericana Vapores, a $2.7 billion shipping group

LUCK OF THE IRISH?

CHILE MUST ALSO REDOUBLE effo to drum up foreign investment, which late has been hovering around $3 billi a year. For inspiration, it is looking to namic small economies such as Irelai Malaysia, and New Zealand. Howev the government's efforts to lure hig tech investment has floundered, in p because it refuses to offer tax incentiv "The only way to get out this commodities rut is attract investment biotechnology or softwa If Costa Rica can attr companies like Intel, should be able to," s Michael Grasty, presid of Oracle Corp.'s Chile erations. Yet Chile sper just 0.6% of GDP on search and developme vs. 2.5% for South Kor

Chile is even consider modifying the individ private retirement counts that replaced government's pay-as-y go system in 1981—an periment emulated wor wide. The accounts h boasted average annual turns of 11.3%, but st fees eat into savings a many cannot afford to c tribute. Other Latin tions would love to h Chile's problems. they're problems Cl needs to tackle if it is to main a model. ■

–By Geri Smit Santi

SWANK Santiago's Providencia district

An Unfinished Agenda

WHAT HAS BEEN DONE

- Economy has grown on average 5.7% annually for the past 15 years
- Poverty has been cut in half since 1990, thanks to well-targeted social programs
- College enrolment has doubled since 1990
- Privately managed pension funds have racked up impressive returns

WHAT NEEDS WORK

- Attract new investment to curb dependence on commodity exports
- Adjust income taxes and introduce antidiscrimination measures to reduce gap between rich and poor
- Reform inflexible labor laws to reduce 24% youth unemployment
- Redesign pension system to improve coverage and force down high fees through competition

Data: BusinessWeek

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DUBAI

A BOURSE IS BORN IN DUBAI

The International Financial Exchange could become a major Mideast player

MOHAMMED BIN RAshid al Maktoum, the Crown Prince of Dubai, is a man who is rarely denied. When the prince decided to plunge into horse racing, it was only a decade or so before his Godolphin stables came to dominate European tracks. When he decided to turn his sun-baked, postage stamp of an emirate into a regional business center, it wasn't long before the skyline was filled with towers.

And for the past three years, Sheikh Mo, as he is widely known, has been driving his aides to build something even more ambitious, a Gulf bourse that will attract global investors. On Sept. 26 this latest creation, the Dubai International Financial Exchange (DIFX), will begin operations.

AWASH IN CASH

THE NEW EXCHANGE'S early days are likely to be modest. A DIFX official says it will start by trading a few index-linked equity products. But the institutions that are likely to be members from the beginning, including Credit Suisse, HSBC, and Deutsche Bank, as well as regional players, have big ambitions for the DIFX. "It has taken a lot of hard work, but we're very excited by the opportunities the DIFX offers investors," says Michael Philipp, CEO of Credit Suisse for Europe, the Middle East, and Africa.

With oil prices hovering around $60 a barrel, the Middle East and the Gulf are awash in cash. The four regional heavy hitters—Saudi Arabia, Iran, Kuwait, and the United Arab Emirates—are likely to rake in a total of $276 billion in oil revenues this year, according to Washington researcher PFC Energy. The flood of money has supercharged the region's markets. Stocks in Kuwait are up 59% this year, while those in Egypt, Jordan, and Saudi Arabia have surged over 80%. If the DIFX takes off, it would give new companies and investors a venue for initial public offerings and other deals that could attract global capital looking for an alternative to lackluster Western markets. "They are making every effort to become the New York Stock Exchange of the region, and I believe they will succeed," says Jameel Akhrass, head of Mideast investment banking for Morgan Stanley, which is planning to become a DIFX member.

Some companies are already doing the preparatory work for DIFX listings. Investcom LLC, which is controlled by Lebanon's Mikati family and operates mobile-phone networks in Cyprus, Syria, and Yemen, says it plans to be among the first companies to list. The offering, which may be around $700 million, is being handled by Citigroup and HSBC. Morgan Stanley is working on another potentially large offering by Showtime Arabia, a Dubai purveyor of broadcast entertainment that is controlled by Kipco, a Kuwaiti investment company. (Viacom Inc. has a minority stake.)

Hot, Hot, Hot

Stock markets in the Middle East are surging higher this year

COUNTRY	% CHANGE YEAR TO DATE
KUWAIT	59.15
SAUDI ARABIA	82.81
EGYPT	86.81
JORDAN	89.28
QATAR	97.09
UAE	118.40

Data: [illegible]

SNAZZY DIGS Rules will be modeled on those of London's stock exchange

DIFX Chairman Lyn Jones says there are 12 t IPOs in the pipeline.

Big-time bankers u to turn up their nose the Middle East because deals were infrequent and too small. But with m ket values booming, banks are chasing crative transactions, such as last ye $3.5 billion sale of a Saudi mobile lice to the United Arab Emirates' Etisa Goldman Sachs & Co. and Cairo-ba EFG-Hermes handled the deal.

Bankers complain that regional changes in locales like Riyadh are parochial or restrictive to handle s transactions. The DIFX could be the s tion. Investors from everywhere wil able to buy and sell easily through member banks. The exchange will qu its listings in dollars, and regulations modeled on those of Britain's Finar Services Authority, which regulates London Stock Exchange. Some critic saying the world doesn't need ano bourse. The backers of the DIFX, Sheikh Mo, are betting otherwise. ■

–By Stanley Reed in D

DITED BY ROSE BRADY

The 'Wrong Signal' on Containing Nukes?

DIDN'T TAKE LONG for the first stumbling block to arise. On Sept. the six nations involved in talks on Pyongyang's nuclear eapons program announced a surprising agreement on prinples for a future accord to eliminate its arsenal. Less than 24 urs later, the North was back to its previous hard line. The U.S. hould not even dream" that North Korea uld dismantle its arms before receiving a t-water nuclear reactor mentioned in accord, declared the Foreign Ministry.

These days, playing hardball with Uncle n has few downsides. And not only rth Korean leader Kim Jong Il is doing it. q's insurgency has dashed the Bush Adistration's hopes that both North Korea l Iran would take a lesson from the topg of Saddam Hussein and bow to dends to give up nuclear ambitions. Inad, Pyongyang and Tehran seem boldened as they face a President unmined by Iraq and the Hurricane Katricleanup. "A weakened President Bush made both countries de- e they have leverage," s Wendy Sherman, a top te Dept. aide in the Clin- Administration who ndled Korean issues.

KIM Playing hardball has few downsides

ina Cleans Up

JING, WHICH is getting h marks for hosting the Party talks, also comes out plomatic winner for keep- them alive. China wrand compromises from shington and Pyong- g—a sign of its growing uence. In exchange for eeing to give up nukes, th Korea won provisions that Bush had g called unacceptable. These range from sibly supplying a light-water reactor, ich produces less bomb-making material, phased-in economic benefits before the th eliminates all its bombs. The pact sn't specify which nation would supply reactor. But the U.S. had earlier held that ngyang should not be rewarded until it fiably destroys its weapons program. sh needs this treaty," says Yan Xuetong, director of Tsinghua University's Institute of International Studies in Beijing. "The U.S. has no energy to deal with North Korea militarily."

Such concessions could have repercussions for Washington's overall effort to combat proliferation. They "send a wrong signal to Iran and other states aspiring to become nuclear powers," warns Lee Jung Hoon, a professor of international relations at Seoul's Yonsei University. Iran is already thumbing its nose at America by resisting curbs on its nuclear activities. The U.S. and the European Union are pressing the International Atomic Energy Agency (IAEA) to refer Iran to the U.N. Security Council for sanctions for violating IAEA rules. Unfazed, Tehran on Aug. 9 said it would resume converting uranium—a process that can lead to the production of weapons-grade fuel—in contravention of an accord with the EU. The U.S. position is made more awkward by its July deal to give India access to nuclear fuel. In contrast to Iran, India has not signed the Non-Proliferation Treaty and has tested bombs.

Iran could well prevail over Uncle Sam, since China and Russia oppose Security Council sanctions. "They have $65 oil, which insulates them against a certain amount of pressure," says a State Dept. official. "Iran is a harder case [than North Korea,] but I'm not going to tell you I'm optimistic about either." The U.S. may be the lone superpower, but it's becoming clearer how limited its clout can be. In the end, Washington may have to live with two new nuclear players. ■

–By Stan Crock in Washington, with Moon Ihlwan in Seoul and Dexter Roberts in Beijing

GLOBAL WRAPUP

CHINA AND JAPAN: A QUARREL OVER ENERGY

JAPAN IS fretting that China appears to be drilling for oil or natural gas near a disputed border in the East China Sea. On Sept. 20, Economy, Trade & Industry Minister **Shoichi Nakagawa** announced that Tokyo had spotted a flame atop a Chinese drilling platform near the median line between the two sides. Japan says a U.N. treaty gives the countries shared rights to the East China Sea and that China's drilling near the median threatens to deplete deposits on Japan's side. China says its continental shelf gives it exploration rights beyond the median. Japan is weighing whether to begin its own drilling: It granted **Teikoku Oil Co.** the job in July. With a U.N. decision on international sea borders years away, no near-term resolution is in sight. Talks on a compromise were suspended in May.

BANK OF ITALY'S FAZIO IS FEELING THE HEAT

PRESSURE IS rising for embattled Bank of Italy Governor **Antonio Fazio** to step down. Rome prosecutors are expected to file formal charges against Fazio soon for abuse of office as part of a wide-ranging investigation of a bank takeover battle involving **ABN-Amro** and Italy's **Banca Antonveneta.** Finance Minister **Domenico Siniscalco** and other officials have called for Fazio's resignation to restore the Bank of Italy's credibility. Fazio, who has a lifetime mandate, has been criticized after transcripts of phone taps were publicized that showed he may have favored an Italian bank in the recent battle for Antonveneta. Fazio claims he did no wrong but may not weather the storm. Parliament is reviewing a draft law that would limit the term for bank governor to seven years.

The real reasons you're working so hard...

...and what you can do about it.

BY MICHAEL MANDEL

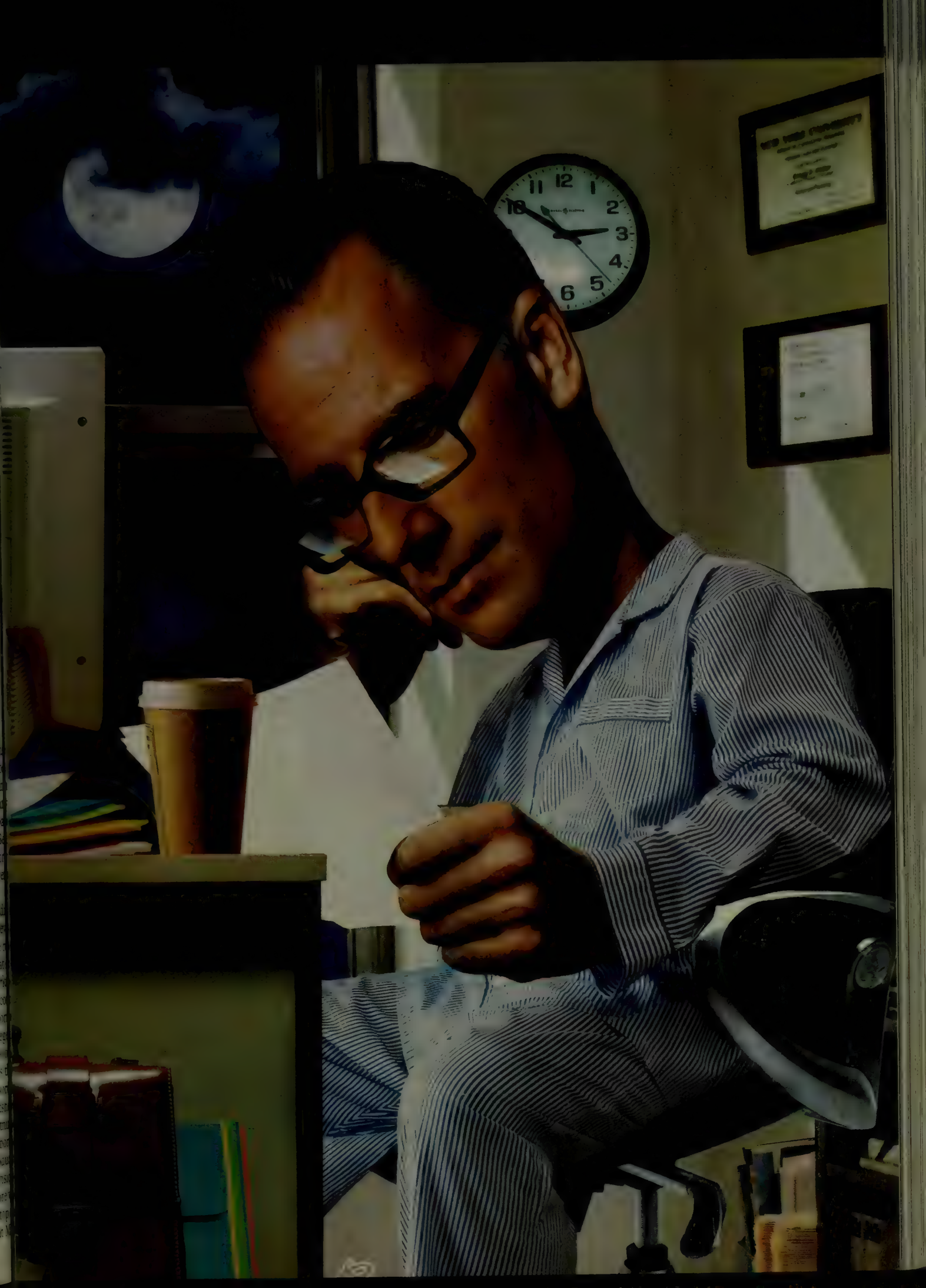
HONK IF THIS SOUNDS LIKE YOU: While much of America is watching Jon Stewart, Letterman, or Leno, you're stumbling out the office door into a car-service Town Car or groping for the clicker to the BMW in the company parking lot. Once home, you slug down a beer or the last of a bottle of white wine on the door of the fridge, stuff some leftovers in your mouth, and collapse into bed beside your sleeping spouse. A half-dozen hours later, you crawl to the shower, throw on a clean shirt, pour some coffee down your throat, maybe drop a kid or two at school, and jump back on the frenetic work treadmill that you can't shut off.

The good news—if there is any, time-challenged amigo—is that you are not alone. Over 31% of college-educated male workers are regularly logging 50 or more hours a week at work, up from 22% in 1980. About 40% of American adults get less than seven hours of sleep on weekdays, up from 34% in 2001. Almost 60% of meals are rushed, and 34% of lunches are choked down on the run. To avoid wasting time, we're talking on our cell phones while rushing to work, answering e-mails during conference calls, waking up at 4 a.m. to call Europe, and generally multitasking our brains out.

This epidemic of long hours at the office—whether physical-ly or remotely—defies historical precedent and common sen Over the past 25 years, the Information Revolution has boo ed productivity by almost 70%. So you would think that sin we're producing more in fewer hours, such gains would tra late into a decrease in the workweek—as they have in the pa But instead of technology being a time-saver, says Warren Be nis, a University of Southern California professor and author such management classics as *On Becoming a Leader*, "eve body I know is working harder and longer."

And the long-hour marathons aren't a result of demandi corporations exploiting the powerless. Most of the groggy-ey are the best-educated and best-paid—college grads whose r wages have risen by more than 30% since the 1980s. That' change from 25 years ago, when it was the lowest-wage work who were most likely to put in 50 hours or more a week, acco ing to new research by Peter Kuhn of the University of Califor at Santa Barbara and Fernando A. Lozano of Pomona Colleg

With so many managers and professionals stuck at wo there is a growing consensus among management gurus t the stuck-at-work epidemic is symptomatic of a serious disor in the organization of corporations. The problem, in a nutsh to-go is this: Succeeding in today's economy requires lightni fast reflexes and the ability to communicate and collabor across the globe. Coming up with innovative ideas, produ and services means getting people across different divisi and different companies to work together. "More and more ue is created through networks," says John Helferich, a top ecutive and former head of research and development at M



LONG-HOURS PREMIUM

Over the past 15 years, real pay for a 55-hour workweek rose by about 14%, but pay for a "normal" 40-hour week hardly budged.

Data: Peter Kuhn, University of California at Santa Barbara and Fernando A. Lozano of Pomona College

terfoods USA, a division of Mars Inc. and the maker of such products as M&Ms. "The guys who are good at it are winning."

Unfortunately, the communication, coordination, and teamwork so essential for success these days is being superimposed on a corporate structure that has one leg still in its gray flannel suit. Without strict gatekeepers (read secretaries), Tom, Jane, and Harry feel free to plug themselves into your electronic calendar. You and a colleague in another part of the company may dream up a great idea for a new product—but it takes months to get approvals from your boss, his boss, and their boss. Or the corporate bigwigs order you to join a taskforce that is supposed to promote collaboration and innovation—but it ends up taking a big chunk of your time. And no matter how many layers of management were supposed to be taken out, there always seem to be more people on the e-mail distribution lists.

You are not imagining things. Despite years of cutting corporate bloat, managers are a much bigger share of the workforce than they were 15 years ago. "We've added a new set of standards without fully dropping the old," says Thomas H. Davenport, professor of information technology and management at Babson College and author of the new book *Thinking for a Living*.

That helps explain why time pressures seem to be getting worse. Globalization and the Internet create great new opportunities, but they also ratchet up the intensity of competition and generate more work—especially with the existing corporate structure still hanging on tightly. "Nobody wants to give up their territory or their control," says Shoshana Zuboff, a former professor at Harvard Business School. Adds Lowell Bryan, a McKinsey & Co. director: "Professionals are still being ma aged as if they were in factories, in organizations designed keep everybody siloed. At less well-run companies, you struck by how frustrated people are. They work like dogs a are wasting time."

Make that lots of time. Fully 25% of executives at large co panies say their communications—voice mail, e-mail, a meetings—are nearly or completely unmanageable. That's a cording to a new McKinsey survey of more than 7,800 ma agers around the world. Nearly 40% spend a half to a full d per week on communications that are not valuable. Other su veys echo similar results. "We're making our people comp with sandbags strapped to their legs," says Zuboff.

A Digital Spine

THERE IS HOPE, HOWEVER, and the promise of at least part liberation from the tyranny of time constraints. Why? Becau the long-term interests of individuals and smart companies a aligned. To compete, successful corporations will have to ma it easier and less time-consuming for their employees to c laborate. They will learn how to live with fewer time-sappi meetings and unnecessary feedback loops—or find themsel outrun by more nimble competitors. The eventual result: l frustration for knowledge workers.

Moves in this direction are already under way as savvy co panies analyze their internal social networks and identify b tlenecks. Intel Corp., for example, sees an opportunity in cre ing technology that lowers the ti cost of teamwork. And others, su as Eli Lilly & Co., are providi more corporate support for both ternal and external networks. "It new mental model for how you r a company," says McKinse Bryan. "The winners will be th who can handle more complexit

At the same time we may se rise in new forms of Web-based ganizations where people can c tribute without having their ti eaten up by existing hierarc Blogs, collaborative online datab es (called wikis) and open-sou software development all use Net to handle much of the coo nation among people rather than lying on top-down command a control. Such a shift to a dig spine could eventually lessen reaucratic time burdens on ov worked professionals, especi those in such high-cost industrie health care.

If history is any guide, the stu at-work epidemic will turn out t

Five Ways To WORK SMARTER

Managers and professionals are running as fast as they can to keep pace with a business world turbocharged by technology. Here's how companies can ease time pressures on their knowledge workers —and boost productivity and innovation at the same time:

- **Manage output rather than hours** Eliminate or reduce low-value activities and meetings. That will allow more time for innovation and creative thinking.
- **Train workers in skills appropriate to a more complex corporate structure** Conduct internal surveys to understand how people really spend their time, and use that information to eliminate the worst bottlenecks.
- **Push decision-making further down the hierarchy** Explicitly broaden the range of decisions that lower-level managers and professionals can make without getting approval.
- **Use new technology to foster collaboration** Develop programs that make it easier to find out what colleagues in other parts of far-flung companies are working on—thus helping to identify resources and avoid duplication. Also, learn from newly developing, nontraditional forms of organization, such as blogs and open-source software.
- **Shift hiring emphasis from supervision to collaboration** Rather than adding more managers, create new positions aimed at facilitating internal and external networks.

TOO MANY COOKS

Managers make up a much bigger share of the workforce than they did 15 years ago despite years of cutting corporate bloat.

Data: Bureau of Labor Statistics

ansitional phase. Historically, as countries and individuals richer, they work less. Look at the late 19th century, when U.S. was still a relatively poor country, with a per capita in- ne about equal to that of China today. Back then the typical le household head had precious little leisure time, perhaps y about 1.8 hours a day, on average, after subtracting time work, chores, and meals. The average factory worker put in ut 60 hours a week, with only one day off. Indeed, the first y Day labor demonstrations, in 1886, were driven by the de- nd for an eight-hour day.

Over time, as U.S. productivity and incomes rose, work hours pped and leisure time increased. It was no coincidence that five-day work week was first introduced in 1926 by Henry d, a decade after he pioneered high-efficiency, mass-produc- n methods.

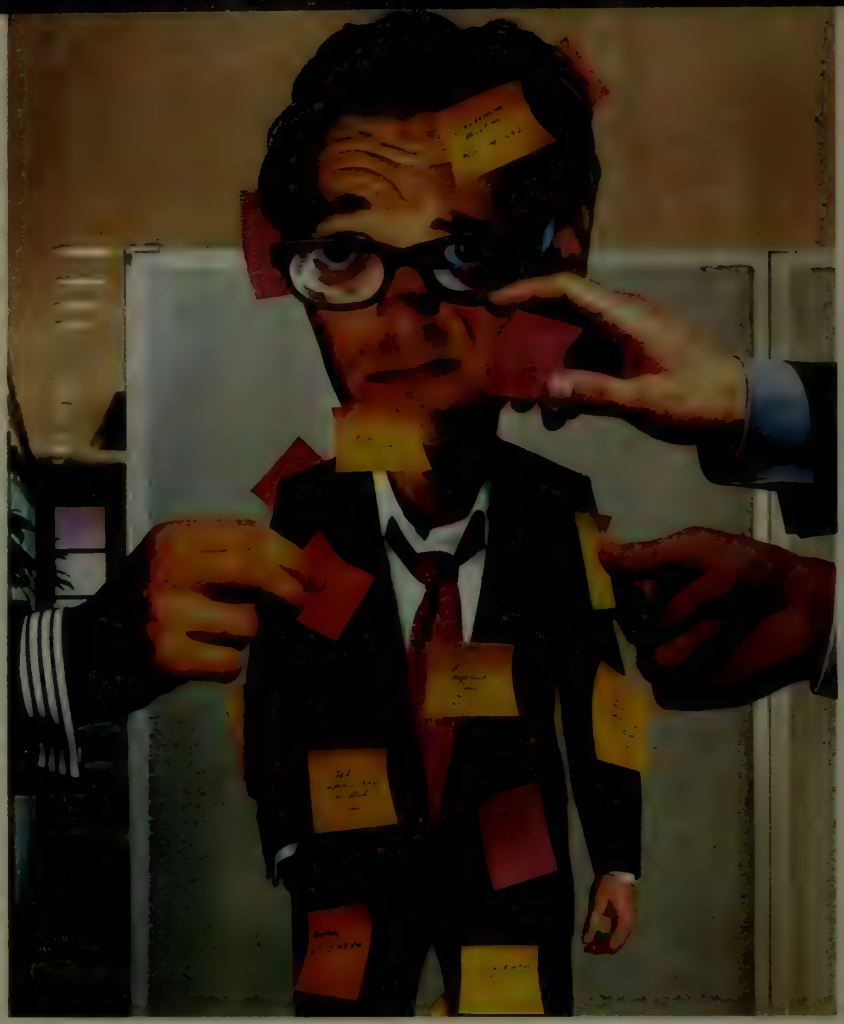
By 1970 the 40-hour workweek was the norm. And, at least il recently, European and Asian countries have followed the e trajectory of declining work hours. Since 1991 average an- l work hours have dropped by 11% in Japan, 10% in France, in Germany and Britain, and 5% in South Korea. Mean- le, average monthly work hours in Taiwan are down by 7% the same stretch. Even work hours in China, while still much higher than in the U.S., may be coming down (page 66). "Asians are poorer and still working like crazy," says Alberto Alesina, a Harvard University economics professor who has studied international work hours. "But as they get richer, they are taking more leisure."

The one real exception to the rule has been the U.S. Since 1991 the U.S. has grown substantially faster than Europe and Japan. Nevertheless, average annual work hours are down by less than 2%, and that includes all the low-skilled workers who are in less demand today.

Interestingly, there are signs that global competition is forcing Europeans to start moving away from their tradition of shorter work hours. The number of Germans working more than 40 hours a week rose sharply last year, to 5.3 million from 4.7 million. Siemens, DaimlerChrysler, Deutsche Bahn, and many smaller companies have been able to increase work hours without corresponding increases in pay. French workers seem to be putting in more hours in the past year or two as well.

European executives are sounding more and more like their American counterparts. "Ten years ago, if I was on a business trip, I'd get to my hotel in the evening, and there might be a message or two from my secretary and a couple of faxes," says Philippe Midy, a Paris-based executive at McDonald's Europe who travels extensively around the Continent dealing with supply and logistics issues. Now there's a deluge. "Sometimes I'm answering e-mails at 2 a.m."

At least at the moment, long hours are part of the price to be paid for faster growth, especially if you work for a multinational. "If you are going to be a participant in economic activity that is part of a globalized market," says Stephen S. Roach, chief



OUT OF CONTROL
About 25% of executives at large companies say their communications—voice mail, e-mails, and meetings—are nearly or completely unmanageable.
Data: McKinsey & Co.

economist for Morgan Stanley, "you need to be prepared to stretch beyond 9 to 5."

Companies have been willing to pay big bucks for those longer hours. Over the past 15 to 20 years, people working a 40-hour week received virtually no increase in real pay, according to research by Kuhn and Lozano. Yet employees putting in a 55-hour week saw their real pay rise by 14%. The implication: The gains of two decades of growth have mainly gone to ambitious—or fearful—Americans who are working longer hours.

But even high pay can't compensate for unrelenting time pressure. Top managers have to realize that encouraging networks and collaboration demands as much attention and resources as supervising and measuring performance in traditional ways. Most companies have built up large human-resources departments, but few have a department of collaboration. "Most managers don't manage social networks effectively," says Babson's Davenpo

At Intel, the drive to reduce the time spent shari knowledge and collaborating is an outgrowth of forts to better coordinate far-flung operations th stretch from Israel to India. One idea being pursued Luke Koons, director for information and knowled management, is "dynamic profiling"—technolog that automatically summarize areas on which researcher or a manager is focusing, based on t subjects of their e-mails and Web searches. Such regularly updated profile could make it less time-co suming to locate potential collaborators and sources, an especially daunting prospect in a larg innovation-minded company such as Intel. Equa important, dynamic profiling doesn't force indivic als to spend hours manually updating their profiles their focus changes.

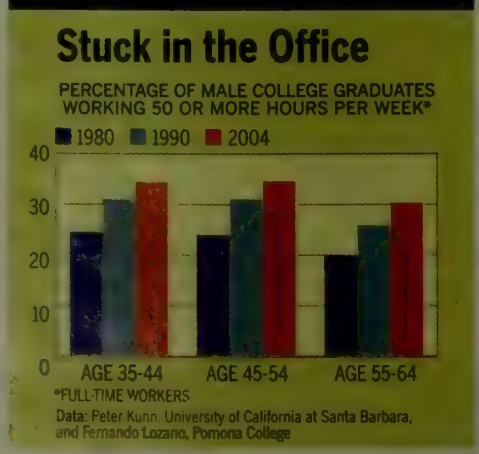
The Off Switch

THERE'S PLENTY OF DEMAND for new technolog that more efficiently foster collaboration, such software that allows virtual meetings, where eve one doesn't need to be present simultaneously. "O communication tools are woefully inadequate," sa Alph Bingham, a top executive at Eli Lilly who vice-president of e.Lilly. "We are still relying on stic ing everyone in a room and hammering it out. I untenable globally."

Another time-eater: all the meetings and e-mails quired to manage details of a collaboration or pa nership. "Organizations need to recognize that wh you engage in collaboration, there's another level complexity," says Bingham. Part of the solution is hire people for a new type of position devoted to fac itating or managing networks and relationships. Li for example, created a new internal group—almost li ombudsmen—to manage communications amo Lilly scientists and myriad outside partners. "This lows the scientists to dedicate less of their time to t collaboration," says Bingham.

Adding new software and more people to reduce t cost of collaboration is great—as long as it doesn't create ev more work. To really ease the work overload—and, not coin dentally, make corporations more nimble—it's also essential identify and eliminate unnecessary interactions. "Sometim people need to remind themselves that there is an off switch and use it," says Paul Saffo, a director the Institute for the Future, a think ta based in Palo Alto, Calif. "Solitude is t scarce resource in business lives—havi that time when you are disconnected a realizing that everything will go along fi without you."

To reduce time pressures—and hi productivity—the number of low-val interactions must be cut. "The usual a sumption is that more collaboration better," says Rob Cross, an assistant pr fessor at the University of Virgini McIntire School of Commerce who al runs Network Roundtable, a resear group whose members include Schlu



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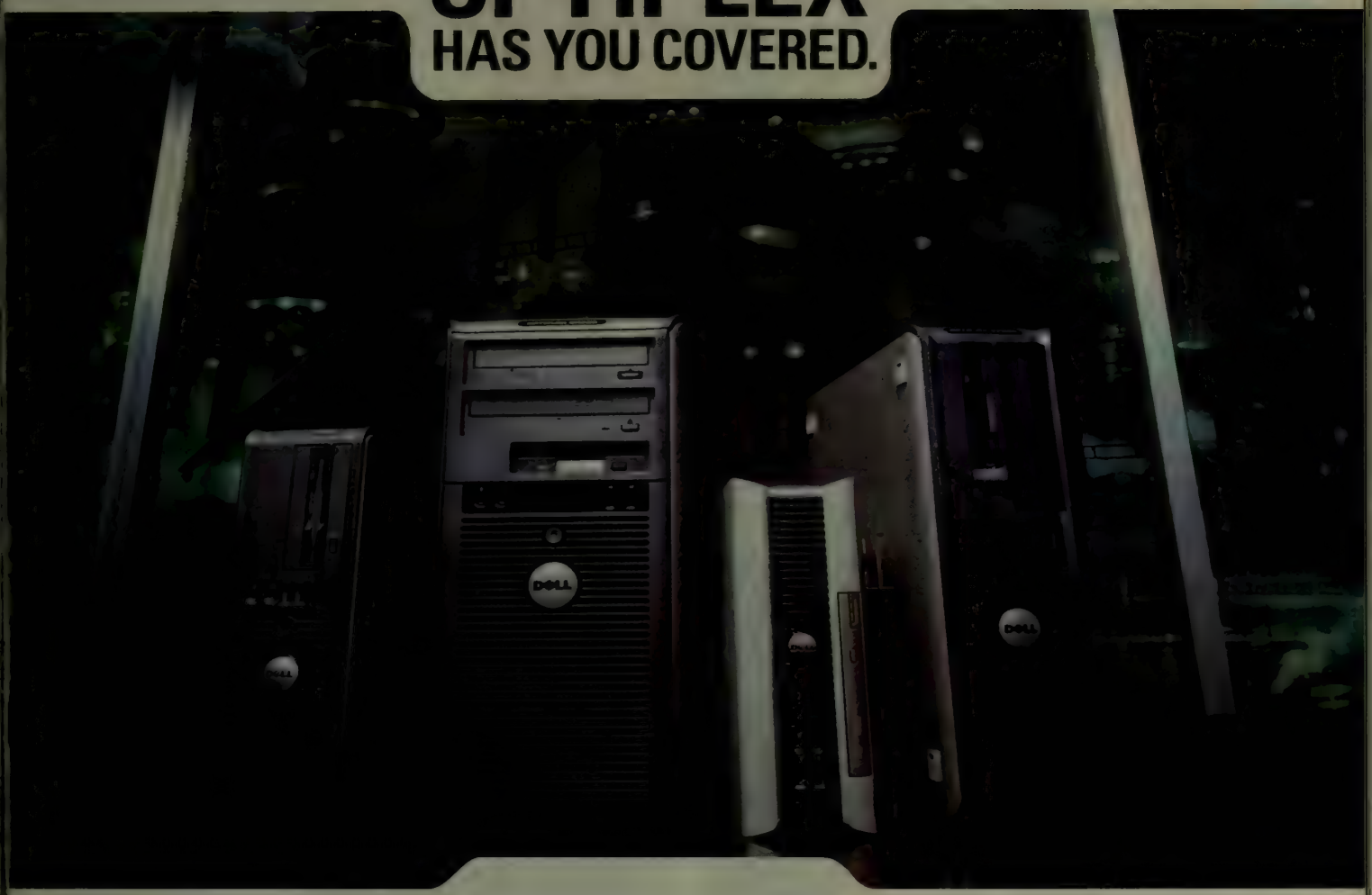

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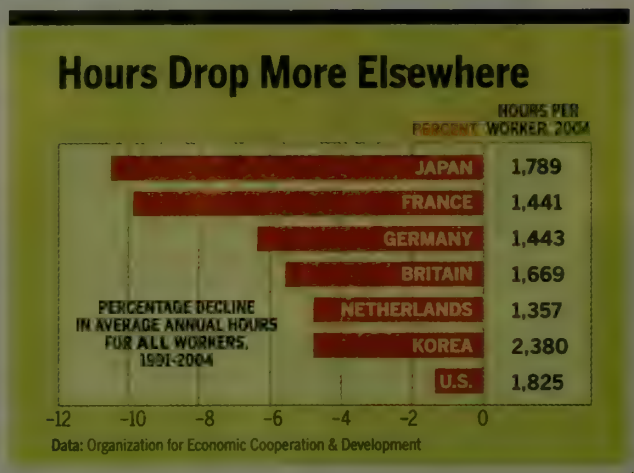
berger, Microsoft, Intel, Merck, and BP. "But it's important to ask not just where we need to build and connect but where do we need to let go?"

By having workers fill out a 15- to 20-minute online survey, Cross can chart who people communicate with, how much time is spent preparing for which meetings, and where the bottlenecks are. "Then I ask executives: 'What decisions are you making that others can make?'" says Cross. "Are there aspects of your role that you could let go of?"



Masterfoods used this methodology to map out how its product development, packaging, and process-development staff spent their time. The results were surprising. "When we looked at the data, it turned out that it was too hard to do business internally," says Helferich, then head of Masterfoods' R&D. People had to talk to 30 or 40 other people just to get their jobs done, which took away from their time to work on new ideas. Notes Helferich: "We were high-density on task and low-density on innovation." Now Masterfoods is in the process of redesigning the workflow of the packaging group to eliminate a lot of the extraneous steps that took up time.

If you are high enough in your organization, you can simply choose when to make yourself unavailable. Bryan, one of McKinsey's top consultants, says he has given up cell phones and computers, letting others handle his communications. "I never had time to think," says Bryan. "It's amazing how much you can get done if you don't spend all your time interacting."

Many of the most overload managers are not yet at a lev where they have the luxury of co trolling their schedules or dispen ing with unproductive e-mai pesky voice mails, and inte minable meetings. But in terms reducing work overload, perha the biggest and most difficult st will be for corporations to give the knowledge workers more freedo over their own time. "The Indust al Age approach to manageme dies a pretty tough death," sa Babson's Davenport. "Even tod people end up being evaluated n only on how much they produce but also on how many hou they are in the office."

Of course, there's one shiny new example of where outp matters more than process: the Web. Nobody cares how long took or what time of night it was when someone wrote a bl entry—all that's seen is the final result. Similarly, the success open-source development projects such as Linux and Apach the most popular Web server software, rests on the competen of the programmers involved, not on how many hours they lo

Reclaiming Your Life

THE WEB MODEL MAY GIVE A GLIMPSE of a less overload way of life that lets people take charge of their time while s making a decent living and a real contribution to society. Ta Ted Husted, a 46-year-old freelance software consultant w

CHINA

A Long March for Workers

Think you've got it bad? Consider Dong Ziaobo, a senior manager at a small, private provider of telecom software services in Beijing whose main client is China Mobile Ltd., the national carrier. Dong, 30 and unmarried, earns almost $2,000 a month—nearly twice what the average city worker makes in a year—but he slogs through 60-hour, six-day weeks. Although about 20 hours of that are overtime, he receives no extra pay. "I have no choice but to work overtime," says Dong. "Anyway, it's my duty to work hard at my job."

More than 300 miles away, in the capital of coal-producing Shanxi province, 31-year-old Liu Bo puts in a very different workweek. As one of 120 teachers at the Taiyuan Middle School, he spends exactly 40 hours over five days a week teaching history class. He never does a minute of overtime. For this, the married Liu earns just under $200 a month. But he's happy with his employment. "I just want to keep teaching my students," says Liu, who adds that as a government-employed teacher he is assured of social welfare benefits such as medical care. "I like my job because I face little stress and can fully enjoy my free time," he says.

In rapidly transforming China, the realities of Dong and Liu exist side by side. According to a study by the International Labor Organization, the Chinese workweek averages 44.6 hours. (In the U.S., it's 39 hours.) And 52% of Chinese workers put in more than 40 hours a week, well above the comparable 28% in the U.S.

Yet the ILO data also point out critical distinctions within the Chinese workforce. In particular, it matters whether you are employed by the state, where work hours are shorter, or in the fast-growing private sector, where the average workweek exceeds 46 hours. "Chinese, especially young people, are facing ever more pressure in their jobs," says Ma Mingjie, director of the Beijing-based *China Youth Daily*'s Social Research Center. According to a survey by the center in April, 65.6% are working longer than eight-hour days, with 20% putting in more than 10 hours.

What's more, the ILO study found that 51% of Chinese workers—unlike those in Japan and South Korea—do not get paid for overtime, says Zeng Xiangquan, dean of the School of Labor & Human Resources at People's University and one of the authors of the study. While blue-collar workers log long hours to earn more money, white-collars do so for less tangible goals such as promotion or personal satisfaction, says Zeng.

Take Wu Xianyong, vice-president for marketing and international business at Beijing athletic gear maker Li-Ning, which is competing with the likes of Adidas-Salomon and Nike in China but intends eventually to vie for international markets, too. "I want to work to build Li-Ning into a global brand," says Wu, who regularly puts in 60-hour workweeks with no overtime pay.

Perhaps surprisingly, given the long hours, China's labor regulations are

CHANGING PLACES

In 1989, Japanese workers put in 10% more hours per year, on average, than American workers. Today the Japanese work 2% fewer hours per year than Americans.

Data: Organization for Economic Cooperation & Development

es in a Rochester (N.Y.) suburb. These days he consults 32 urs a week, remotely, for the Oklahoma Environmental Qual- Dept., down from 40 as recently as this summer. But he also ends 10 to 15 hours a week as a major contributor to the ache open-source software project.

Now he has time on weekends to watch his kids play sports. goes out to lunch with his wife, Barb, every Monday. And he en has time left over to contain the fast-growing maple trees his corner lot. Meanwhile, his work on the open-source proj- garners him visibility and respect among his peers. "I think an keep this pace up indefinitely," says Husted. "But I have to ve discipline about it. Now I make sure there's at least one y when I don't even touch a keyboard."

Few people will ever make a living as a blogger or a con- butor to an open-source software project. But there is pres- re to find new ways of organizing work, from both corpora- ns and overworked individuals. "In terms of hours, I ep thinking we're on the verge of a backlash," says Babson's venport.

Try telling that to Ken Middleton, director of convention es for Houston's Convention & Visitors Bureau. In the after- th of Hurricane Katrina, he has been putting in grueling 70- ur weeks hustling to find space for meetings that had been eduled for New Orleans. Even in normal times, though, he rks 55 hours a week, including four to six hours on week- ends. Does he feel overworked? "Absolutely—but doesn't everyone? My wife says I need to get a hobby and stick to it. There isn't time for that right now." Who has even a moment for a backlash? ■

–With Steve Hamm in New York, Carol Matlack in Paris, Christopher Farrell in St. Paul, Minn., and Ann Therese Palmer in Chicago

The Art of Taking Time Off

Achieving Work/Life Balance: PricewaterhouseCooper's managing partner in Chicago, Jay Henderson, shares his tips on making time for leisure without losing traction at work

Chill Out: A small-business owner talks about why he takes vacations—and why his fellow entrepreneurs should, too

"The more I work, the more money I can make": Residential loan officer Michael Rome on why he's willing to put in extra hours

Online Poll: How many hours do you work? What can your company do to make your job more manageable? Let us know

Join the discussion on work overload and what can be done about it at Mike Mandel's blog at businessweek.com/the_thread/economicsunbound

BusinessWeek online

http://www.businessweek.com/extras

BEIJING SLOG

In three Chinese cities, 51% of people who worked overtime during workdays received no extra pay

Data: International Labor Organization (based on survey data from Beijing, Guangzhou, and Changsha)

"actually good—and pretty much in keeping with international norms," says Constance Thomas, director of the ILO Office for China and Mongolia in Beijing. The laws mandate 44-hour, five-day workweeks; two weeks of annual leave; regular holidays; and a minimum of one-and-a-half time pay for overtime. Moreover, those mandated work hours are down from close to 50 hours in a six-day week before 1995. But that doesn't mean the laws are widely followed, particularly in the fast-growing, unregulated sector of the economy or where migrant workers are involved. "It's a big country with a lot of regions that still need to develop," Thomas says. "We see differences in how the labor law is applied."

The jury is still out on what comes next. Although Chinese yuppies are starting to value free time and with labor law moving toward better protection of workers, the rapid growth of private enterprise is likely to mean longer working hours. "There is a push-pull effect," says the ILO's Thomas. And that means that at least for some time to come, all those 60-hour workweeks will help keep the Chinese economic engine roaring.

–By Dexter Roberts in Beijing

The Overworked, Networked Family

How the 21st-century household is using new technology to balance jobs and leisure. BY CHRISTOPHER FARRELL

BRING UP WORK-AND-FAMILY BALANCE AT A NEIGHBOR'S barbecue, and the conversation immediately swerves toward tales of rushing out of meetings at breakneck speed to shuttle the kids to soccer practice or struggling to tear ourselves away for a decent vacation. Laments about time pressure are so routine that they have become a common cultural vocabulary. Everybody, it seems, is stressed out about time, and achieving "balance" has become the Holy Grail of middle-class family life.

But maybe balance is the wrong image. Instead, think transformation. Just as businesses are shifting from Industrial Age hierarchies to collaborative networks, so, too, is the American family undergoing a parallel social revolution. Parents and children are no longer on the same schedule—unlike the way things were a generation ago. With many educated mothers and fathers working longer hours, they are linked to their kids by a web of cell phones and e-mails.

At the same time, kids are taking the initiative to pursue more activities and are using information technologies to nurture their own electronic networks of relationships, from friends at school to cousins in distant cities. "The catalyst for change has been the same in the work hemisphere and family time," says Julie Morgenstern, a time management consultant and founder of Task Masters in New York. "It's technology."

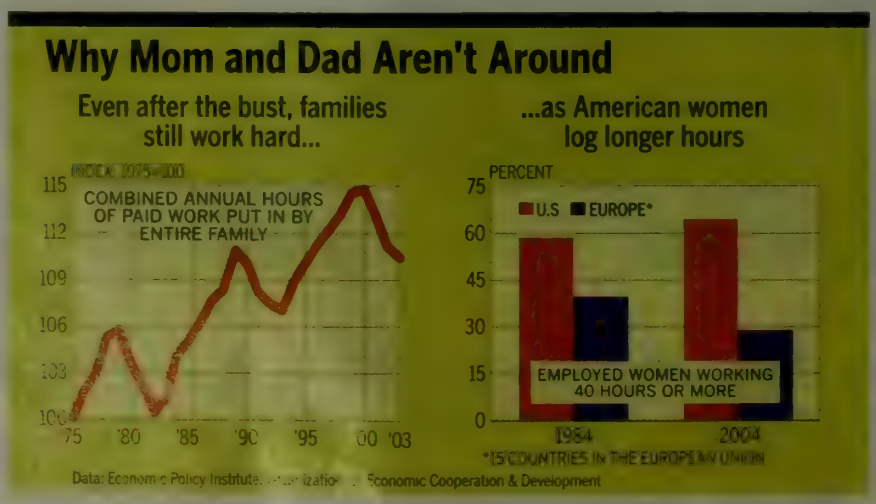
The networked economy is leading to far different standards and expectations of what it means to be a parent and a child. It's not simply enough for the young to get an education. Instead, the goal is to raise children to be creative and adaptable, able both to compete successfully and to collaborate with their Chinese and Indian peers. "We have an economy [whose] functioning depends for the first time on the enhancement of human capability," says Richard Florida, professor of public policy at George Mason University in Fairfax, Va. Adds Luke Koons, director of information and knowledge management at Int Corp.: "Fourteen-year-olds are truly collaborating a thinking together. There's a lot we can learn to apply to a co porate setting."

So how can the typical overworked white-collar American bombarded by e-mails, beset with late-night meetings, and co fronted with unexpected business trips—simultaneously ma age at warp speed and cope with the new challenges at hom Gradually, a new body of shared rules-of-thumb is emergin passed along at playgrounds and in offices. Among ther Transform technology from an oppressor into a liberator. love tech," says Margaret M. Foran, senior vice-president a associate general counsel at Pfizer Inc., who uses her BlackBe ry and her cell phone to mix work and family time. "I can go the soccer games at 3 p.m. I can go to the play, the book sale, t science demonstration, and the doctor appointments."

Home Sweet Workplace

OTHERS HAVE MASTERED the art of interweaving work ob gations and home life in a way that was not possible before, a swering an e-mail from work one minute and helping wi homework the next. And the younger members of the family already far more sophisticated at multitasking and networkin than their parents—are getting a chance to see what approac es work and what falls flat. "My daughter, now working, know how important it is use her time well," sa Carrie J. Hightma president of SBC Illinoi who is married to a r gional administrator f Pitney Bowes Inc. "S has seen me do it. No she's doing it."

Historically, the o ganization of the fami has mirrored, to son degree, the organizatio of the workplace. Tal the classic middle-cla family of the 1950s a '60s, the "Golden Ag



nomy of strong productivity growth and lush gains in real ges. With a secure corporate job, Dad could afford to work much more than 40 hours a week, and Mom could stay at ne to raise the children. The family of that era did many ngs together. The classic example is eating dinner every ning at the kitchen table. The kids also tagged along when m and Dad visited friends. In essence, a family acted like a gle unit, with a hierarchy that mirrored the top-down man- ment of factories or large industrial organizations of the day, h as General Motors Corp.

Fast-forward to the 2000s. Today, both Mom and Dad are re likely to have careers. The combined workweek of a hus- d and wife in their prime working years with children is 68 rs, up from 59 hours in 1979, according to calculations by Economic Policy Institute. The better educated the couple, more hours they put in. At the same time, their jobs have nged. The rote work is either being done by computers or is he process of being outsourced to Asia. Instead, what's left the more complicated and creative tasks that can't be easi- educed to a set of instructions.

At home, standards for a healthy, emotionally rich family life are a lot higher than they used to be. Schedules during "leisure hours" are crammed with music lessons and play dates for the kids, exercise classes for Mom, and occasional tee times for Dad. Parents are aware that colleges and universities look more favorably on high school students with a demonstrated ability to do many things well, not unlike the skills they will need in the workplace. Says Ann Swidler, a sociologist at the University of California at Berkeley: "It's the complex management of a life with a wealth of choices."

LIKE FATHER, LIKE SON On weekends, Ruder often works at home, where he says "it's easier on me"

To achieve these goals, families are learning to turn technology to their advantage. Yes, BlackBerrys, cell phones, e-mail, and other high-tech gear erode traditional boundaries between the office cubicle and the kitchen table, or even the bedroom. But many time-pressed workers now realize that technology creates greater possibilities for busy families to stay in touch and, at the same time, increase family time.

Brian Ruder agrees. A principal at Francisco Partners Management LLC, a Menlo Park (Calif.) venture-capital fund, Ruder, who has a 3-year old son, estimates he works several hours

IN TOUCH ALL DAY

BlackBerrys, cell phones, and e-mail create endless possibilities for communication and can help increase family time

Tips For Avoiding BURNOUT

A generation ago, the good manager was organized, planned ahead, and set goals—both on the job and at home. Today the watchwords are flexibility, coordination, and communication

» Set Priorities Pareto's Principle says that 20% of what you do creates 80% of the value. Flag the tasks that really need your attention, and back-burner or outsource the rest.

» Be Flexible Leave yourself time to adjust to unforeseen events and new information in both your professional and personal life. Scheduling too many activities in too short a time frame inevitably creates stress.

» Build in Buffers Time-management experts say it's easy to get overwhelmed when you don't build in enough time to switch from one task to another. When mapping out your day, give yourself a breather between different activities.

» Stay in Touch No longer do workers have to choose between work and family. Technology offers the flexibility to manage schedules around family events, and vice versa. Don't forget: there's always an off button.

» Practice Active Screening Yes, you're always reachable through some sort of electronic gizmo. But if logging off on weekends and evenings isn't an option, do the next best thing: Use technology to screen your calls and e-mails.

» Understand the Limits of Technology Face time still matters, both in the office and at home. Hold a weekly family meeting to coordinate schedules, raise family matters, and address money concerns.

» Fuel Your Creativity Run a marathon, learn how to cook, listen to music. Such activities offer rest, relaxation, and time to think creatively while not worrying about a deadline.

over the weekend while at home. "All my friends and family have seen me punching away on my BlackBerry and talking on my cell phone, so the general perception of how much time I am working has gone up even more than the amount of time I am working," muses Ruder. Yet he doesn't yearn for "the good old days" when he went to the office on Saturdays and Sundays. "Because of technology, I probably spend more time working on the weekend now, but it's easier on me because I can work at home, then take a run, and go out to brunch with friends," he says.

TIME TO THINK
Dolan values her long-distance runs as a chance to mull over work and family issues

Other parents follow a different but equally successful st egy for using technology. While raising her kids, now in colle Nell Minow worked three days a week out of her home offic suburban Washington. Her job: editor and co-founder, w Robert Monks, of the Corporate Library, a corporate go nance evaluation firm based in Portland, Me. "That wa dream way to work," says Minow. "E-mail enables me to be cessible, so I don't have to live in Portland at the Corporate brary's headquarters." Today, Minow is also Yahoo! In "Movie Mom," reviewing four to five films a week.

But just as excessive e-mails and conference calls fill up t on the job, there's a temptation to use the technology to c too much in at home well. "You have to con the technology and mak work for you, not w you," says Minow. "If I myself: 'I'm not going check my e-mail for days,' I stick with it."

Indeed, in a world wh creativity and innovat are so highly prized, more important than to create space to th Janet Dolan is CEO of T nant Co., a Golden Va (Minn.) multinatio specializing in clear and maintenance produ with $500 million in an al revenue. She has run company, raised two dren, maintained a r riage, volunteered in community, and serve several boards. For long-distance runnin her solution for gaining time she needs to think atively about work

new

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1, 2 AND 3 MG TABLETS

ntroducing Lunesta,™ a brand new sleep aid that can change your nights.

Even when your restless mind keeps you wake, brand new Lunesta can give your body nd mind the soothing sleep you need. Lunesta not only helps most people fall asleep fast, it helps you sleep all through the night. Peacefully, uninterrupted. Lunesta works quickly, so you hould only take it right before bed. And unesta is non-narcotic, and approved for long-erm use. Of course, do not use sleep medicines or extended periods without first talking to our doctor.

Now's the time to catch the sleep you need. If you've been hesitant to take a prescription sleep aid, be sure to ask your doctor about Lunesta.

Important Safety Information: Be sure you have at least eight hours to devote to sleep before becoming active. Until you know how you'll react to Lunesta, you should not drive or operate machinery. Do not use alcohol while taking Lunesta. All sleep medicines carry some risk of dependency. Side effects may include unpleasant taste, headache, drowsiness and dizziness. *See important patient information on the next page.*

Leave the rest to Lunesta

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Lunesta™
(eszopiclone)c
1, 2 AND 3 MG TABLETS

Please read this summary of information about LUNESTA before you talk to your doctor or start using LUNESTA. It is not meant to take the place of your doctor's instructions. If you have any questions about LUNESTA tablets, be sure to ask your doctor or pharmacist.

LUNESTA is used to treat different types of sleep problems, such as difficulty in falling asleep, difficulty in maintaining sleep during the night, and waking up too early in the morning. Most people with insomnia have more than one of these problems. You should take LUNESTA immediately before going to bed because of the risk of falling.

LUNESTA belongs to a group of medicines known as "hypnotics" or, simply, sleep medicines. There are many different sleep medicines available to help people sleep better. Insomnia is often transient and intermittent. It usually requires treatment for only a short time, usually 7 to 10 days up to 2 weeks. If your insomnia does not improve after 7 to 10 days of treatment, see your doctor, because it may be a sign of an underlying condition. Some people have chronic sleep problems that may require more prolonged use of sleep medicine. However, you should not use these medicines for long periods without talking with your doctor about the risks and benefits of prolonged use.

Side Effects

All medicines have side effects. The most common side effects of sleep medicines are:

- Drowsiness
- Dizziness
- Lightheadedness
- Difficulty with coordination

Sleep medicines can make you sleepy during the day. How drowsy you feel depends upon how your body reacts to the medicine, which sleep medicine you are taking, and how large a dose your doctor has prescribed. Daytime drowsiness is best avoided by taking the lowest dose possible that will still help you sleep at night. Your doctor will work with you to find the dose of LUNESTA that is best for you. Some people taking LUNESTA have reported next-day sleepiness.

To manage these side effects while you are taking this medicine:

- When you first start taking LUNESTA or any other sleep medicine, until you know whether the medicine will still have some effect on you the next day, use extreme care while doing anything that requires complete alertness, such as driving a car, operating machinery, or piloting an aircraft.
- Do not drink alcohol when you are taking LUNESTA or any sleep medicine. Alcohol can increase the side effects of LUNESTA or any other sleep medicine.
- Do not take any other medicines without asking your doctor first. This includes medicines you can buy without a prescription. Some medicines can cause drowsiness and are best avoided while taking LUNESTA.
- Always take the exact dose of LUNESTA prescribed by your doctor. Never change your dose without talking to your doctor first.

Special Concerns

There are some special problems that may occur while taking sleep medicines.

Memory Problems

Sleep medicines may cause a special type of memory loss or "amnesia." When this occurs, a person may not remember what has happened for several hours after taking the medicine. This is usually not a problem since most people fall asleep after taking the medicine. Memory loss can be a problem, however, when sleep medicines are taken while traveling, such as during an airplane flight and the person wakes up before the effect of the medicine is gone. This has been called "traveler's amnesia." Memory problems have been reported rarely by patients taking LUNESTA in clinical studies. In most cases, memory problems can be avoided if you take LUNESTA only when you are able to get a full night of sleep before you need to be active again. Be sure to talk to your doctor if you think you are having memory problems.

Tolerance

When sleep medicines are used every night for more than a few weeks, they may lose their effectiveness in helping you sleep. This is known as "tolerance." Development of tolerance to LUNESTA was not observed in a clinical study of 6 months' duration. Insomnia is often transient and intermittent, and prolonged use of sleep medicines is generally not necessary. Some people, though, have chronic sleep problems that may require more prolonged use of sleep medicine. If your sleep problems continue, consult your doctor, who will determine whether other measures are needed to overcome your sleep problems.

Dependence

Sleep medicines can cause dependence in some people, especially when these medicines are used regularly for longer than a few weeks or at high doses. Dependence is the need to continue taking a medicine because stopping it is unpleasant.

When people develop dependence, stopping the medicine suddenly may cause unpleasant symptoms (see *Withdrawal* below). They may find they have to keep taking the medicine either at the prescribed dose or at increasing doses just to avoid withdrawal symptoms.

All people taking sleep medicines have some risk of becoming dependent on the medicine. However, people who have been dependent on alcohol or other drugs in the past may have a higher chance of becoming addicted to sleep medicines. This possibility must be considered before using these medicines for more than a few weeks. If you have been addicted to alcohol or drugs in the past, it is important to tell your doctor before starting LUNESTA or any sleep medicine.

Withdrawal

Withdrawal symptoms may occur when sleep medicines are stopped suddenly after being used daily for a long time. In some cases, these symptoms can occur even if the medicine has been used for only a week or two. In mild cases, withdrawal symptoms may include unpleasant feelings. In more severe cases, abdominal and muscle cramps, vomiting, sweating, shakiness, and, rarely, seizures may occur. These more severe withdrawal symptoms are very uncommon. Although withdrawal symptoms have not been observed in the relatively limited controlled trials experience with LUNESTA, there is, nevertheless, the risk of such events in association with the use of any sleep medicine.

Another problem that may occur when sleep medicines are stopped is known as "rebound insomnia." This means that a person may have more trouble sleeping the first few nights after the medicine is stopped than before starting the medicine. If you should experience rebound insomnia, do not get discouraged. This problem usually goes away on its own after 1 or 2 nights.

If you have been taking LUNESTA or any other sleep medicine for more than 1 or 2 weeks, do not stop taking it on your own. Always follow your doctor's directions.

Changes In Behavior And Thinking

Some people using sleep medicines have experienced unusual changes in their thinking and/or behavior. These effects are not common. However, they have included:

- More outgoing or aggressive behavior than normal
- Confusion
- Strange behavior
- Agitation
- Hallucinations
- Worsening of depression
- Suicidal thoughts

How often these effects occur depends on several factors, such as a person's general health, the use of other medicines, and which sleep medicine is being used. Clinical experience with LUNESTA suggests that it is rarely associated with these behavior changes.

It is also important to realize it is rarely clear whether these behavior changes are caused by the medicine, are caused by an illness, or have occurred on their own. In fact, sleep problems that do not improve may be due to illnesses that were present before the medicine was used. If you or your family notice any changes in your behavior, or if you have any unusual or disturbing thoughts, call your doctor immediately.

Pregnancy And Breastfeeding

Sleep medicines may cause sedation or other potential effects in the unborn baby when used during the last weeks of pregnancy. Be sure to tell your doctor if you are pregnant, if you are planning to become pregnant, or if you become pregnant while taking LUNESTA.

In addition, a very small amount of LUNESTA may be present in breast milk after use of the medication. The effects of very small amounts of LUNESTA on an infant are not known; therefore, as with all other prescription sleep medicines, it is recommended that you not take LUNESTA if you are breast-feeding a baby.

Safe Use Of Sleep Medicines

To ensure the safe and effective use of LUNESTA or any other sleep medicine, you should observe the following cautions:

1. LUNESTA is a prescription medicine and should be used ONLY as directed by your doctor. Follow your doctor's instructions about how to take, when to take and how long to take LUNESTA.
2. Never use LUNESTA or any other sleep medicine for longer than directed by your doctor.
3. If you notice any unusual and/or disturbing thoughts or behavior during treatment with LUNESTA or any other sleep medicine, contact your doctor.
4. Tell your doctor about any medicines you may be taking, including medicines you may buy without a prescription and herbal preparations. You should also tell your doctor if you drink alcohol. DO NOT use alcohol while taking LUNESTA or any other sleep medicine.
5. Do not take LUNESTA unless you are able to get 8 or more hours of sleep before you must be active again.
6. Do not increase the prescribed dose of LUNESTA or any other sleep medicine unless instructed by your doctor.
7. When you first start taking LUNESTA or any other sleep medicine, until you know whether the medicine will still have some effect on you the next day, use extreme care while doing anything that requires complete alertness, such as driving a car, operating machinery, or piloting an aircraft.
8. Be aware that you may have more sleeping problems the first night or two after stopping any sleep medicine.
9. Be sure to tell your doctor if you are pregnant, if you are planning to become pregnant, if you become pregnant, or if you are breastfeeding a baby while taking LUNESTA.
10. As with all prescription medicines, never share LUNESTA or any other sleep medicine with anyone else. Always store LUNESTA or any other sleep medicine in the original container and out of reach of children.
11. Be sure to tell your doctor if you suffer from depression.
12. LUNESTA works very quickly. You should only take LUNESTA immediately before going to bed.
13. For LUNESTA to work best, you should not take it with or immediately after a high-fat, heavy meal.
14. Some people, such as older adults (i.e., ages 65 and over) and people with liver disease, should start with the lower dose (1 mg) of LUNESTA. Your doctor may choose to start therapy at 2 mg. In general, adults under age 65 should be treated with 2 or 3 mg.
15. Each tablet is a single dose; do not crush or break the tablet.

Note: This summary provides important information about LUNESTA. If you would like more information, ask your doctor or pharmacist to let you read the Prescribing Information and then discuss it with him or her.

Rx only

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TOGETHERNESS Saldana tries to compartmentalize her time. "Otherwise, you'll drive yourself crazy," she says

FIRST THINGS FIRST

When you get home from work, pay attention to what really matters —your kids and spouse. The household chores are secondary

mily issues. "People need to be able to think," she says. "We ed to carve out time rather than fill in time."

Other busy people have found that it's important to maintain rly strict boundaries between work and home. Maria Saldana head of U.S. investment banking for Popular Securities in icago, a subsidiary of the nation's largest Hispanic financial stitution, Banco Popular of North America Inc. She's also the other of four children, ages 10 to 20, and president of the ard of Commissioners for Chicago Park District, an organition that manages the city's 7,300 acres of parkland, lakefront operty, football stadiums, museums, and an aquarium. Still, e has learned that it pays to compartmentalize her time. hen I'm home, I'm home," says Saldana. "Otherwise, you'll ive yourself crazy."

rial and Error

TTING PRIORITIES IS CRITICAL. One thing people can do, ys consultant Morgenstern, is to not answer their e-mail for e first hour they're at work. Instead, devote that time to the ost important tasks that require creativity and concentration. at's advice that Alan Brown, chief marketing officer at Nuen Investments and the father of three school-age children, is following. When he came to Nuveen four years ago, he was determined to spend more time with his kids and family. "In the past, I've felt that at times there's more emphasis on activity instead of meaningful results," he says. Now, "I'm spending time at work on things that are important rather than trying to attend to everything."

What's the equivalent at home? Pay attention to what really matters—your kids and spouse—when you get back from work. Says Morgenstern: "Household chores are secondary."

It's important to note that there's no one-size-fits-all solution for the problem of reconciling long hours at work with a healthy family life. What's more, individuals can accomplish only so much acting on their own. Schools and other major community institutions still behave as though the 40-hour workweek were the rule rather than the exception. And corporations are still loading new responsibilities and commitments onto managers and professionals, without taking away any of the old ones.

Nevertheless, what's fascinating about the current focus on managing work and family time is that it's rooted in an abundance of possibilities. Through trial and error, with many stumbles along the way, the networked family is starting to figure out how to take advantage of the many opportunities available today. And that's progress. ■

–With Ann Therese Palmer in Chicago

CORPORATE PROFILE

BRINGING THE IRAQIS TOGETHEI

MTC Atheer is set to become Iraq's leading mobile telecommunications network

Mr. Ali Al-Dahwi, President and General Manager of MTC Ath

MTC Atheer is a veritable telecommunications pioneer. The company, which is part of the MTC Group, was licensed to install and operate a GSM network in southern Iraq in December 2003. Today, it has the widest mobile telecommunications network, extending from southern Iraq all the way to Baghdad, with over 850,000 subscribers. Since commencement and by the end of 2005, a total of US$430 million will be invested servicing a target customer base of 1.5 million.

But this resounding success is just the tip of the iceberg. MTC Atheer entered what was essentially a difficult market, where mobile services were nonexistent, and where fixed line services were inadequate and unable to meet the needs of the Iraqis. In a short period of time, MTC Atheer connected all southern cities, including Basra, Amara, Nasiriya, Karbala, Najaf and more, and soon afterward Baghdad, providing high-quality mobile services in a region with virtually no alternative communication services. Now spanning 13 governorates in southern and central Iraq, MTC Atheer is looking to expand into the northern part of the country. "Today Iraq has more than 3 million mobile customers. The growth rate, despite of the conditions in Iraq, is for example higher than Egypt, which has a 10% penetration rate. This is a good sign," says Mr. Ali Al-Dahwi, President and General Manager of the company. "And the average Iraqi is willing to pay US$150 for a mobile line and phone in order to carry out their business and communicate with each other and the rest of the world."

The only mobile operator with a 100% Iraqi workforce

MTC Atheer was able to attract and retain its large number of customers by providing innovative and quality services at reasonable prices. "We are proud to be providing the best service to the Iraqi people and will be enhancing the network by 50% before the end of this year," says Mr. Al-Dahwi.

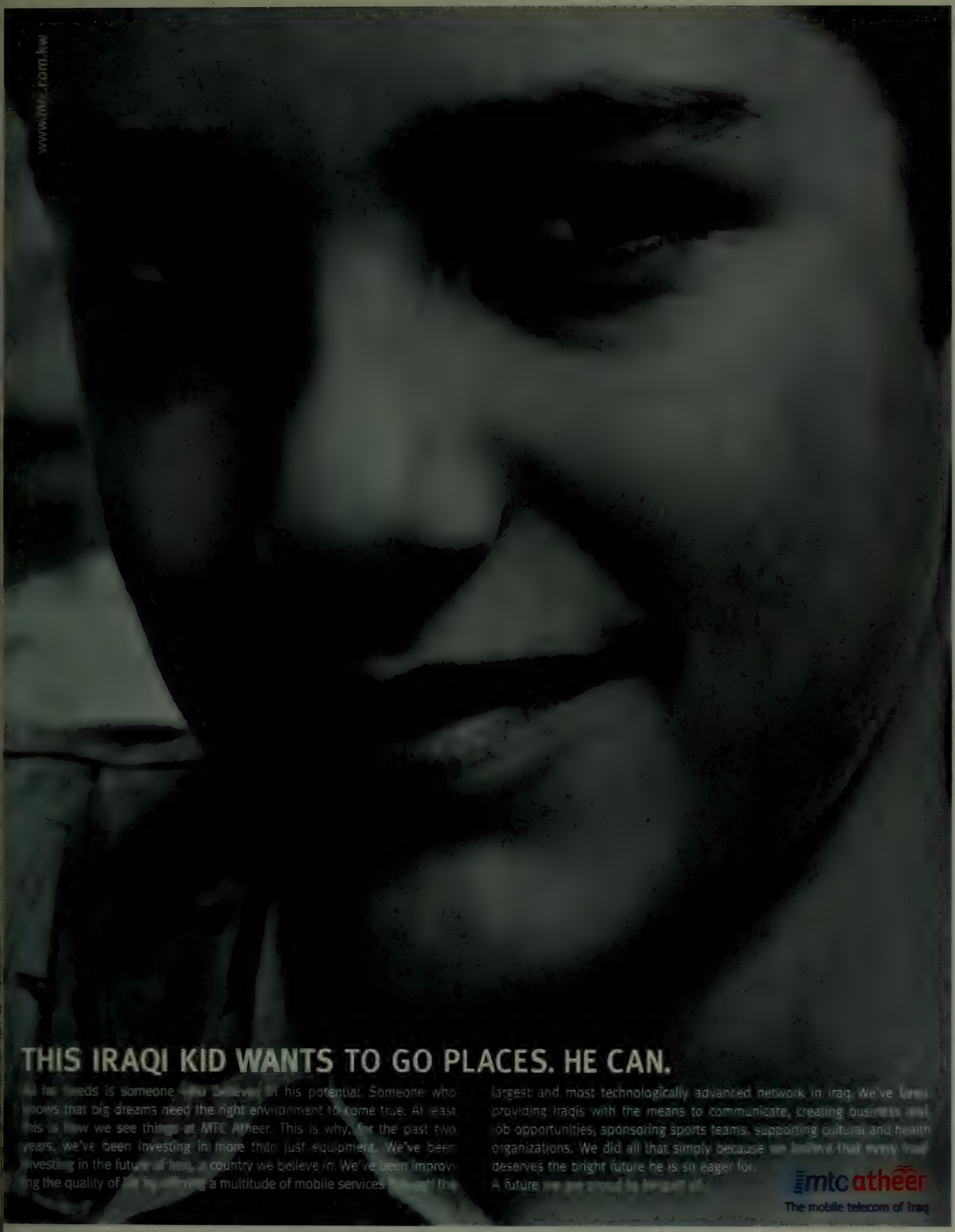
MTC Atheer's prime positioning inside the Iraqi telecommunications industry makes it a powerful contender for one of the five new 15-year licenses for mobile networks, which are scheduled to be auctioned off before the end of the year by the National Communications and Media Commissio (NCMC). The three existing two-year licenses, whic were awarded by the US-led coalition authority, expire i December 2005.

More than just a telecommunications company, MTC Athee aspires to become part of Iraq's social fabric. The compan employs 600 Iraqis in Basra and Baghdad, and it is proud t be the only mobile operator with a 100% Iraqi workforce Some 10,000 direct and indirect work opportunities will hav been created in Iraq by the end of 2005. Th company is also extremely active within th community and sponsors humanitarian cultural and educational projects, in additio to special organizations such as the Iraq Olympic Football Team and the Iraq National Symphony Orchestra.

MTC Kuwait has management control of th operation and owns 30% of MTC Atheer Founded in 1983 in Kuwait, the paren company MTC (Mobile Telecommunication Company) has since grown to become the leading mobil operator in 5 Middle East and 13 sub-Saharan African countrie with over 11 million subscribers.

The Group has shown it understands that great opportunitie are available in the burgeoning Iraqi market. With the world' third largest oil reserves, a skilled and educated workforce an a massive GDP growth of 50% in 2004, Iraq is the ke economic player to watch in the Middle East region.

"I firmly believe that Iraq is a promising country fo investors internationally and regionally especially when i comes to telecommunications," says Mr. Al-Dahwi.



mtc

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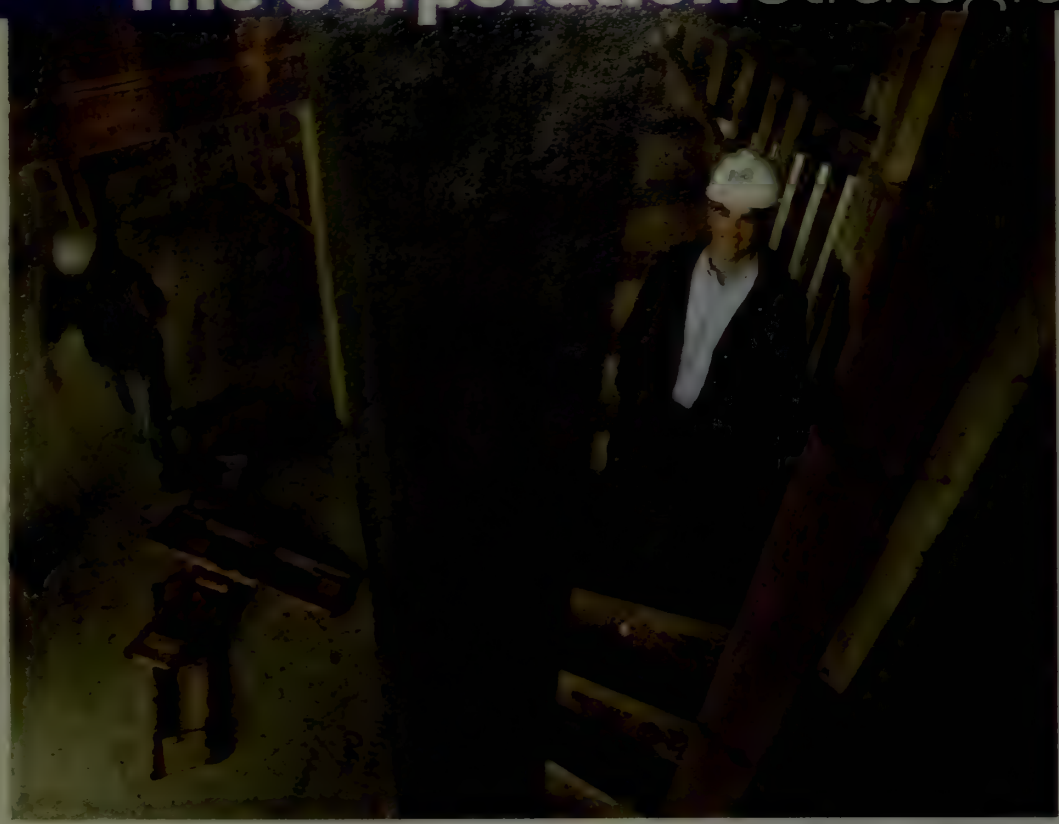
GABON | KENYA | MALAWI | NIGER | REPUBLIC OF THE CONGO | SIERRA LEONE | TANZANIA | UGANDA | ZAMBIA



SIMPLIFIER Dugas is scaling back the number of Pulte floor plans

A New Blueprint At Pulte Homes

CEO Dugas' plan for insulating the red-hot homebuilder from downturns

RICHARD J. DUGAS JR., the chief executive of Pulte Homes Inc., has become an unlikely interior decorator for the company's chairman and founder, Bill Pulte. Dugas has littered the 73-year-old's Bloomfield Hills (Mich.) office with window frames, floor tiles, a display of faucets—even a kitchen sink.

There's a good explanation for the visual chaos: Pulte Homes is choosing a common set of fixtures to use nationally, and Dugas has been sending the samples. It's one part of the company's ambitious effort to rethink the homebuilding business for the 21st century. Dugas wants to exploit Pulte's size, making broad decisions from the Michigan home office in a bid for more efficiency and cost savings. That's a big shift in the hidebound homebuilding industry—which has resisted centralization while catering to widely varying regional tastes, zoning restrictions, and weather. "Dugas is a leader, and he thinks his way out of the box," says Pulte. "That's what it takes today."

Clearly, Dugas has the founder's support. It helps that the CEO, at the helm since 2003, has the company on a roll. Pulte Homes stands out in an industry thriving on low interest rates and skyrocketing home prices. Profits rose 61% last year to $987 million and increased 60% more in the first half of 2005. Orders for new homes rose 19%, to a record 25,650 units in the first six months of the year, while the value of those orders rose 28%. Pulte's $11.6 billion in homebuilding revenue leads the industry. Investors have enjoyed a total return of more than 200% over the past three years. Such results helped land Pulte Homes the No. 12 spot on the BusinessWeek 50 list of top corporate performers.

STREAMLINING

BUT DUGAS KNOWS that the housing market won't be red-hot forever and has plotted his strategy accordingly. Like other homebuilders, Pulte has bought growth: The 2001 acquisition of Del Webb Corp., the top builder of homes for the swelling ranks of active retirees, boosted the bottom line by 33%. It also added geographic and demographic diversity. Pulte's 28-state spread should cushion it from a regional real estate slump. Just as crucial, though, is Dugas' push to bring a corporate discipline to Pulte's operations. "The homebuilding industry is still run like a mom-and-pop business," Dugas says. "There are huge opportunities to streamline." He expects a more efficient Pulte to expand its 4% share of U.S. new-home sales to more than 10% within a decade.

Of course, centralizing what has always been essentially a local business carries risks. After all, houses in a suburb of Albuquerque are necessarily different from those outside Boston. Managers in Michigan need to choose carefully as they narrow the number of floor plans and home amenities to be sure they account for regional tastes. "They'll either have a great head start on the rest of the industry or be behind the eight ball," says Stephen East, an analyst at Susquehanna Financial Group LLC in Bala Cynwyd, Pa.

The Best Performers

In rethinking what a modern homebuilder should look like, Dugas has plucked ideas, buffet-style, from all over the business world. From manufacturers such as Toyota Motor Corp., Pulte is borrowing the notion of reducing product variation to save money and remove complexity. Dugas is whittling the number of Pulte floor plans from 2,200 to 600 by yearend, keeping only those that have proven popular from coast to coast. Another Toyota lesson: make upscale features standard to get economies of scale. "When you buy a Lexus, you get leather," Dugas says of

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oyota's luxury division. They don't bother with inyl or fabric." Now, luxury arpets and top-notch appliances are *de rigueur* in Pulte ouses—making purchases mpler for buyers.

Dugas also seeks to use ulte's scale to build a more ficient supply chain, using Wal-Mart tores Inc. as his model. Homebuilders sually let subcontractors buy materials nd fixtures. Now, Pulte buys directly om manufacturers in bulk, using its heft get a better price. Steven C. Petruska, ulte's chief operating officer, estimates at offering fewer options, and buying a national scale, will save 5% to 10%. ike Wal-Mart, Pulte will use regional distribution centers to deliver materials for a house just when they are needed.

Wal-Mart's supply chain is Dugas' model

To ensure his big ideas will be implemented properly, Dugas has aggressively raided companies with strategies that he admires, recruiting 50 new managers in the past three years. For instance, he's lured a hospitality whiz from Sandcastle Resorts & Hotels Inc. to head customer relations, and a Wal-Mart logistics guru, as Pulte tries to import the retail titan's legendary supply-chain discipline.

Engineering a smooth transition with all the new faces will be a management challenge for Dugas, 40, who wasn't even a twinkle in his parents' eyes when Bill Pulte began building houses in 1950. But the CEO has now put in 11 years at Pulte, after working as a marketer at Exxon and a logistics manager at PepsiCo Inc. And despite Dugas' urbane manner and slicked-back hair—a contrast to the less-polished founder—"He has gotten his boots muddy," Bill Pulte says with obvious pride in his protégé.

With profits soaring, Dugas has momentum on his side. But rising interest rates are worrisome, since higher mortgage rates would discourage some home buyers and dampen sales growth. And anything that cools the housing market would hurt the value of Pulte's $8.9 billion inventory of land and unsold homes.

Then there's the competition. Other big homebuilders are trying some of the same tactics—though none are reconceiving strategy as completely as Pulte. For instance, KB Home is standardizing components such as window frames, and working to create a steady flow of construction, using some of the same lean-manufacturing techniques. Toll Brothers Inc. and Centex Corp. are manufacturing some housing components off-site to boost efficiency.

That's one reason Dugas feels such urgency about transforming Pulte, despite the many potential pitfalls. Avoiding change until sales slip would be a huge mistake, says Dugas. "We're attacking this while we're strong." In an industry that is consolidating rapidly, he's betting that a reinvention is the surest way for the Pulte name to stand the test of time. ■

–By Kathleen Kerwin in Bloomfield Hills, Mich.

Building for the Long Haul

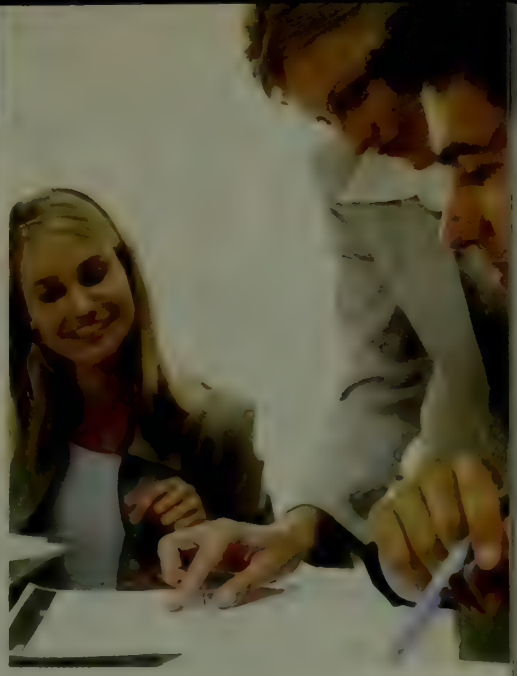
A runaway housing market has helped profits at Pulte Homes jump by an average of 48% over the past three years. But the company believes its strategy will hold up for the long term, even if the ever-expanding real estate bubble bursts in some markets.

DIVERSIFY Pulte builds projects ranging from starter homes to retirement communities in 28 states. That insulates it from a slump in any one region or segment.

CENTRALIZE CEO Dugas is trying to standardize housing designs, materials used, and purchasing, and run them through the home office in Bloomfield Hills, Mich. He expects that to reduce complexity and generate economies of scale.

STREAMLINE Pulte brought in a Wal-Mart logistics whiz to streamline the way materials are sent out to building sites nationwide. To reduce costs and raise quality, options offered to buyers are being trimmed.

Data: Pulte Homes Inc.



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TOGETHER, GREAT THINGS HAPPEN

GREEN TRUCKS

DRIVING TRANSPORTATION TO BETTER EFFICIENCY AND PERFORMANCE

Trucks are the workhorses of our economy. They move goods cross-country or across town, transport personnel during the workday, and bring packages to our doors. Their ubiquitous presence at such diverse locations as construction sites, major ports, and loading docks at retail stores and supermarkets is a reminder that they are inextricably tied to our daily lives. Their effect, both environmentally and economically, is profound.

Today, these trucks and the companies that depend on them face increasing economic, environmental, and regulatory pressures. High fuel costs take their toll on the bottom line, making operating efficiencies paramount. Environmental performance is a focus and a challenge. Fleet operators, truck manufacturers, and engine suppliers strive to bring increasingly more sophisticated products to the highway to meet these challenges head on.

"Between fuel economy pressures and environmental regulations, the trucking industry is going through a period of rapid change," points out John Boesel, president and CEO of the advanced transportation consortium WestStart-CALSTART, based in Pasadena, Calif. "This is a time of great opportunity for those manufacturers and fleets that are forward-looking and willing to make use of the best that technology can offer."

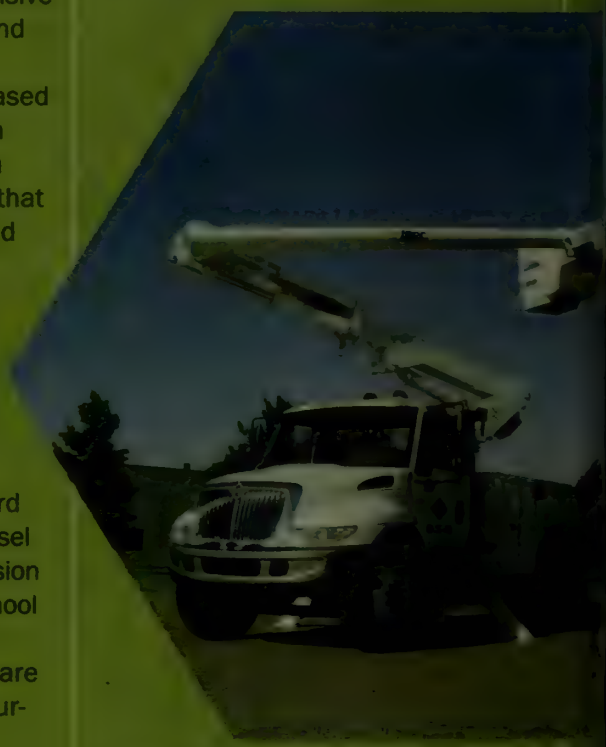
WITH CHANGE, OPPORTUNITY

WestStart-CALSTART, a non-profit organization, facilitates the commercialization of technologies that improve air quality and reduce dependence on foreign oil. Its 115 member companies are among the leaders in the commercial trucking industry, and each has its story. One of these stories is being written by International Truck and Engine Corp., which has been developing clean-burning diesel engines through years of extensive research, laboratory testing, and on-the-road demonstration.

In 2000, Warrenville (Ill.)-based International brought its Green Diesel Technology to market, a three-level technology system that cuts gaseous hydrocarbons and particulate emissions by 99%, to near-zero levels. Since that time, the technology has been used in buses in California, with more than 100 currently on the road. A year after its introduction, California's Air Resources Board certified the clean-air Green Diesel Technology school bus for inclusion in its program to retire older school buses, qualifying Green Diesel Technology school buses to share in state funding for new bus purchases by school districts.

"The flexibility of Green Diesel Technology provides International the edge to design application-specific solutions," says Jack Allen, president of International's engine group. "Very clean diesel engines require the integration of multiple technologies, which Green Diesel Technology provides through advanced air management, selected fuel system applications, proprietary combustion strategies, electronic controls, and optimized after-treatment solutions, benefiting society's clean air goals and the performance goals of business."

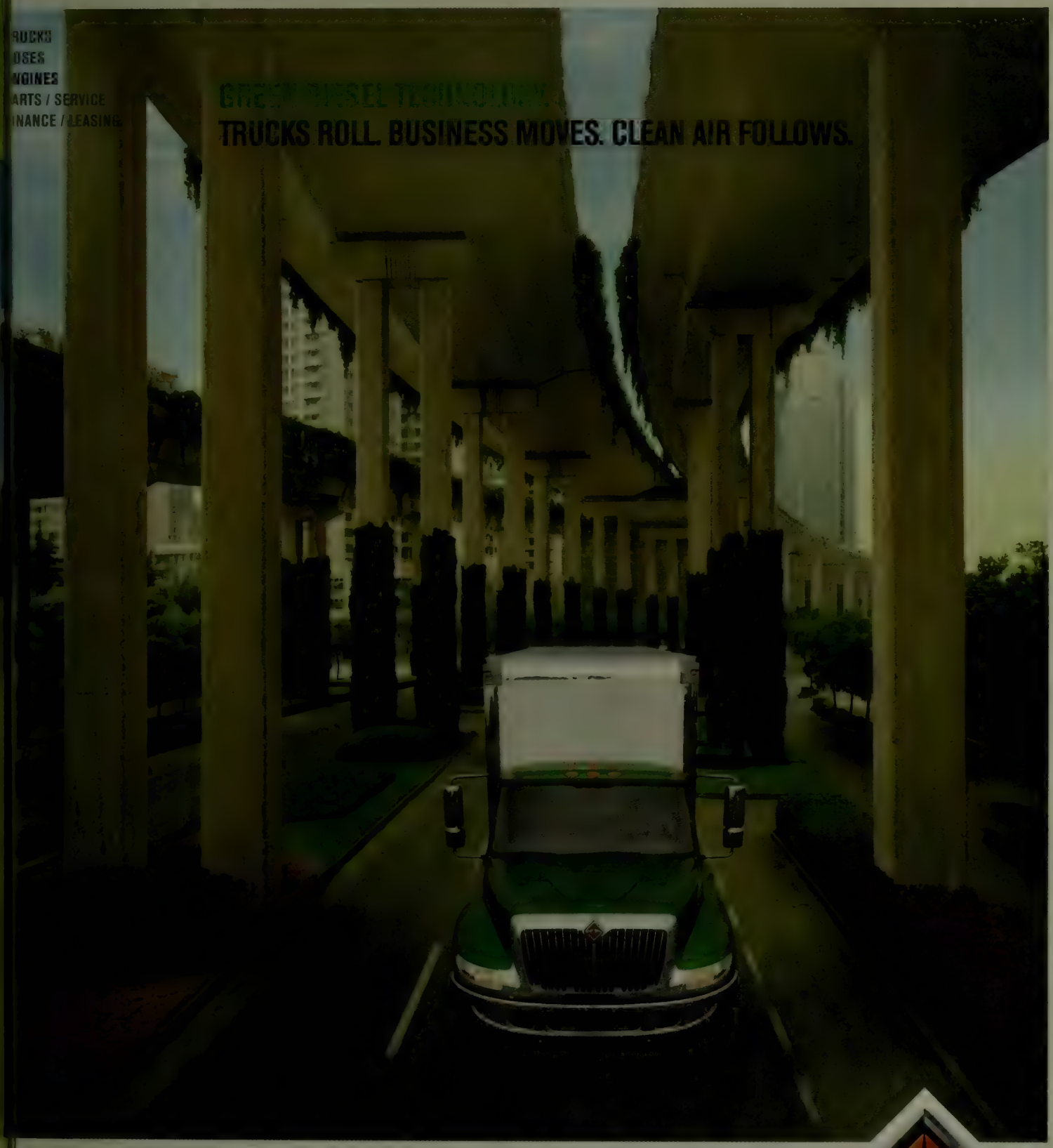
"In 2007 and beyond, the importance of integration between truck and engine design will be a competitive advantage for International and International's customers," adds Dee Kapur, president of International's truck group. "Clean air goals and outstanding vehicle performance are best accomplished with integrated vehicle systems that deliver clean air and an outstanding customer experience, like reduced noise and vibration for the driver's environment, without sacrificing diesel performance or efficiency."



Above: This International/Eaton diesel-electric hybrid truck is part of a national pilot program.

SCRUBBING THE SULFUR

Like most efforts that are seeking to provide cleaner and more efficient diesel product, International's advanced diesel technology requires ultra-low sulfur diesel (ULSD) fuel. Though already available in some areas of the country today, starting in October 2006 the Environmental Protection Agency will require most diesel fuel intended for use on America's highways to have sulfur levels that do not exceed 15 parts per million, a move likened by some to taking lead out of gasoline in the 1970s. This ULSD fuel enables the



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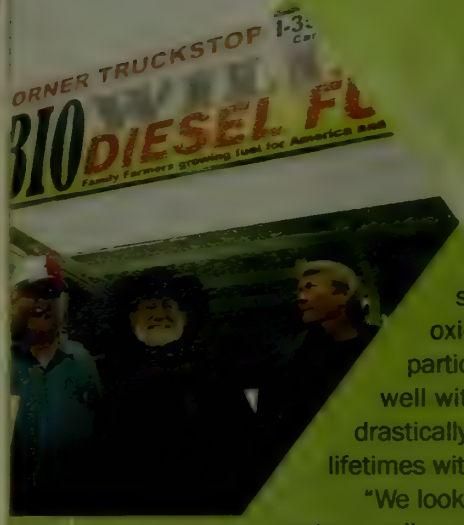


use of advanced emissions-control devices like oxidation catalysts and particulate traps, which work well with ULSD but suffer drastically reduced operating lifetimes with high sulfur fuel.

"We look at it as the clean diesel system really coming together," says Allen Schaeffer, executive director of the Diesel Technology Forum, an industry organization based in Frederick, Md. "The cleaner fuels, the advanced engines, and the emissions control systems are three pieces being optimized that, working together, really chart the course for the next generation of clean diesel technology." Schaeffer adds that major milestones coming up for heavy-duty highway commercial vehicles in 2007 should bring greater than a 98% reduction in emissions of nitrogen oxides and particulate matter compared to 10 or 15 years ago, with an additional 90% reduction between 2007 and 2010.

New EPA regulations do not affect the approximately 11 million engines in use today. Fortunately, the same clean diesel technologies that will power the next generation of on- and off-road diesel vehicles and equipment can be applied to some older engines, reducing emissions by up to 90%.

BEHOLD THE 21ST-CENTURY TRUCK

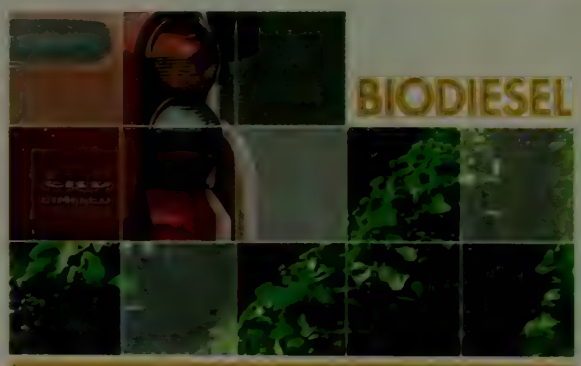
The 21st-Century Truck Program, inaugurated in 2000, is a multi-agency and industry partnership aimed at increasing fuel efficiency, reducing emissions, enhancing safety, reducing ownership and operating costs, and maintaining or enhancing performance. Government participants include the EPA, Department of Energy, Department of Transportation, and Department of Defense, which highlights common civilian and military truck technology goals as well as the potential transfer of military and civilian technologies.

A key element is the program's "roadmap." This plan establishes technical targets and fuel efficiency goals, for 2010 and beyond, that seek to substantially increase truck fuel economy while meeting prevailing emission standards and also displacing petroleum fuels by 5%. The program includes heavy-duty hybrids along with its focus on diesel and renewable fuels.

UNITED IN A COMMON GOAL

An example of this focus on fuel efficiency is provided by International and Eaton Corp., which were recently selected to manufacture diesel-electric hybrid trucks for a national pilot program serving the utility industry. The two companies are developing an integrated diesel-hybrid powertrain that will be tested in at least 20 factory-built International utility trucks, using an International DT 466 in-line six-cylinder diesel engine with an Eaton hybrid-electric drivetrain. WestStart, which operates its Hybrid Truck Users Forum, will be administering the pilot program with the support of the U.S. Army's National Automotive Center.

Bringing advanced hybrid-truck technology to customers is also an area of focus at UQM Technologies Inc., in Frederick, Colo., a manufacturer of small, lightweight, and efficient motors, generators, and power electronic controllers. Applications range from electrically intensive series hybrids, in which all power to the wheels is provided by electric motors, to lower-power parallel (mild) hybrids in which the engine and electric motor both provide power to the wheels. UQM systems are under evaluation in tractors, trucks, buses, and on- and off-highway military vehicles such as the U.S. military's Family of Medium Tactical Vehicles (FMTVs), plus manned and unmanned vehicle applications.



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These advantages have attracted customers ranging from Deere & Co., Stewart & Stevenson, and Eaton to the U.S. Army, Navy, Marine Corps, and Air Force.

UQM Technologies is additionally developing innovative ways to help engine and vehicle manufacturers meet 2010 diesel emission standards through improved auxiliary systems that eliminate parasitic loads on engines – an area of focus of the 21st-Century Truck Roadmap. By replacing belted, geared, and hydraulic driven water pumps, oil and fuel pumps, fan drives, and air conditioning with electrically driven units, electric auxiliaries can operate as needed, independent of any power supplied by the engine. This approach provides increased fuel efficiency and reduced engine load over conventional systems that operate continuously when directly connected to an engine.

Below: The military is evaluating advanced hybrid truck technology for its FMTVs.

IMAGINE THE POSSIBILITIES

Diesel fuel is the trucking industry's fuel of choice for many reasons, primary among them its widespread availability. However, there are markets where alternative fuels could become popular, especially where fleets always operate on the same route and regularly refuel at the same locations. Other possibilities include dual-fuel vehicles that can operate on an alternative fuel when available and conventional diesel fuel when it is not, or alterna-

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WESTSTART-CALSTART is North America's leading advanced transportation technologies organization. As a participant-supported non-profit of more than 115 companies and agencies, it is dedicated to expanding and supporting a high-tech transportation industry that cleans the air, creates jobs, and improves energy efficiency, while lessening dependence on foreign oil and reducing global warming. It plays a national role facilitating advanced systems and fuels for transit and heavy-duty vehicles, and new forms of mobility.

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tive fuels that can be seamlessly substituted for diesel fuel.

Biodiesel falls into the latter category. An alternative fuel that can be made from any fat or vegetable oil, typically domestically grown soybeans, biodiesel works in any diesel engine with few or no modifications. It can be used in pure form or blended with petroleum diesel at any level, the most popular fuel mixtures being B2 (2% biodiesel and 98% conventional diesel), or B20 (20% biodiesel). In addition to its growing popularity for use in passenger vehicles, biodiesel is used by more than 500 major commercial fleets across the country. More than 500 retail filling stations make biodiesel available to the public, and some 1,400 petroleum distributors carry it nationwide.

The use of biodiesel yields numerous environmental benefits, including significant reductions in carbon monoxide emissions, particulate matter, unburned hydrocarbons, and sulfates. On a lifecycle basis, biodiesel reduces carbon dioxide by 78% compared to petroleum diesel.

According to the National Biodiesel Board, a nonprofit trade association, in Jefferson City, Mo., dedicated to coordinating the biodiesel industry and educating the public about the fuel, this makes biodiesel the most effective greenhouse gas-mitigation technology currently available for heavy-duty vehicles and equipment. Biodiesel's inclusion in the landmark Energy Bill recently signed into law shows recognition by Congress and President Bush that biodiesel is an important part of the solution for reducing dependence on foreign oil, boosting the economy, and benefiting the environment.

WALKING THE WALK

Another popular alternative fuel that's been a focus of private, public, and government fleets at all levels for years is clean-burning natural gas. One of the largest privately owned fleets in the country is found at Pacific Gas and Electric Co., which has been operating alternative fuel vehicles since [illegible] and now has more than 850 natural gas vehicles in its own fleet, including gas service trucks, meter reader vehicles, and pool cars.

Providing alternative fuels with the opportunity to compete has long been a focus at San Francisco-based PG&E. The utility's support of its customers' use of green technologies has brought many success stories, among them 26 compressed natural-gas refuse trucks operating in Sunnyvale, Calif. On a larger scale, hundreds of natural gas trucks are in operation with Waste Management Inc., California's leading provider of solid waste and recycling services. Starting with one of the first pilot projects in 1995, Waste Management's fleet of natural gas vehicles has grown to 462 trucks running on compressed and liquefied natural gas. Looking to the future, PG&E will continue its focus on green technologies while working with its customers and government agencies to advance its vision of clean natural-gas vehicles as part of the solution to air quality challenges.

Above: PG&E has a fleet of 850 natural-gas vehicles.

"The state has been making good progress to improve air quality, but current policy ignores growing concerns about petroleum dependency," says Brian Stokes, manager of the clean air transportation division at PG&E. "The legislature has approved $150 million a year in incentive programs to facilitate fleet emission-lowering conversions and new cleaner vehicle purchases. However, most of these funds are going to diesel retrofits and re-powers because

the incentive program criteria are based on current cost effectiveness. Unfortunately, improving petroleum product performance by itself is only part of the solution, and we will never get to a diversified portfolio of fuels with this strategy. The criteria need to be adjusted to give emerging alternative fuels – that have the potential of achieving cost-effectiveness with near-term subsidies – a chance to compete."

THE MORE THINGS CHANGE...

"Even with the advanced technology that lies on the horizon for fuel cells and hydrogen vehicles, there's always going to be a vital role for diesel technology," says the Diesel Technology Forum's Schaeffer. "When we examine the reasons why people are using diesel today, we find they're the very same reasons why people used diesel many decades ago." According to Schaeffer, it's really the whole package – a unique combination of fuel efficiency, performance, and unmatched power density that's able to deliver more horsepower and more force to get the job done using the lowest amount of fuel possible.

Indeed, all technologies and fuels that make trucks operate cleaner and more efficiently – from advanced diesel and biodiesel to hybrid-electric and natural gas – are increasingly important to not only the bottom line, but energy security and our quality of life. It's a challenge that is being well met by companies large and small in a dedicated effort to bring trucks and fuels into a new era.

WEB DIRECTORY

Diesel Technology Forum
http://www.dieselforum.org

International Truck and Engine Corp.
http://www.internationaldelivers.com

National Biodiesel Board
http://www.biodiesel.org

Pacific Gas and Electric Co.
http://www.pge.com

UQM Technologies Inc.
http://www.uqm.com

WestStart–CALSTART Inc.
http://www.calstart.org

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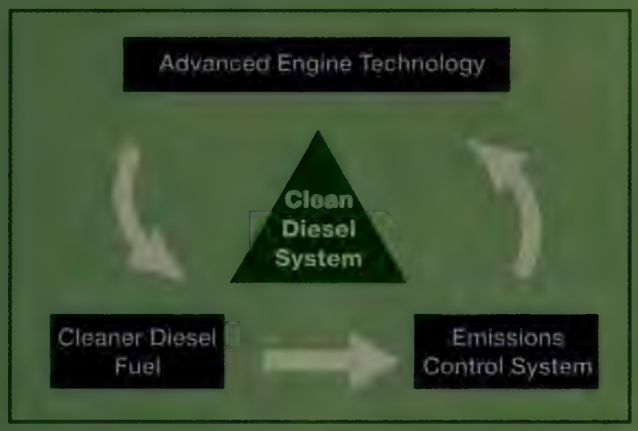
What is Clean Diesel?

Clean diesel combines advancements in state-of-the-art **diesel engines**, cleaner burning **fuel** and effective **emissions control systems** to deliver power and efficiency with near-zero emissions levels.



The Engine

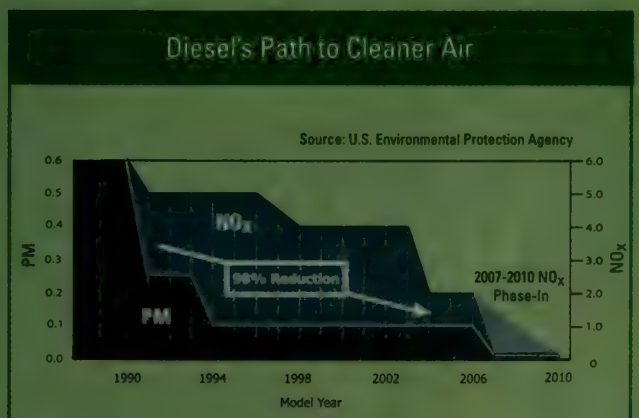
Advanced engine technologies such as electronic controls, high-pressure common rail fuel injection, variable injection timing, improved combustion chamber configuration, and turbocharging have made diesel engines *cleaner, quieter,* and *more powerful* than ever before.

The Fuel

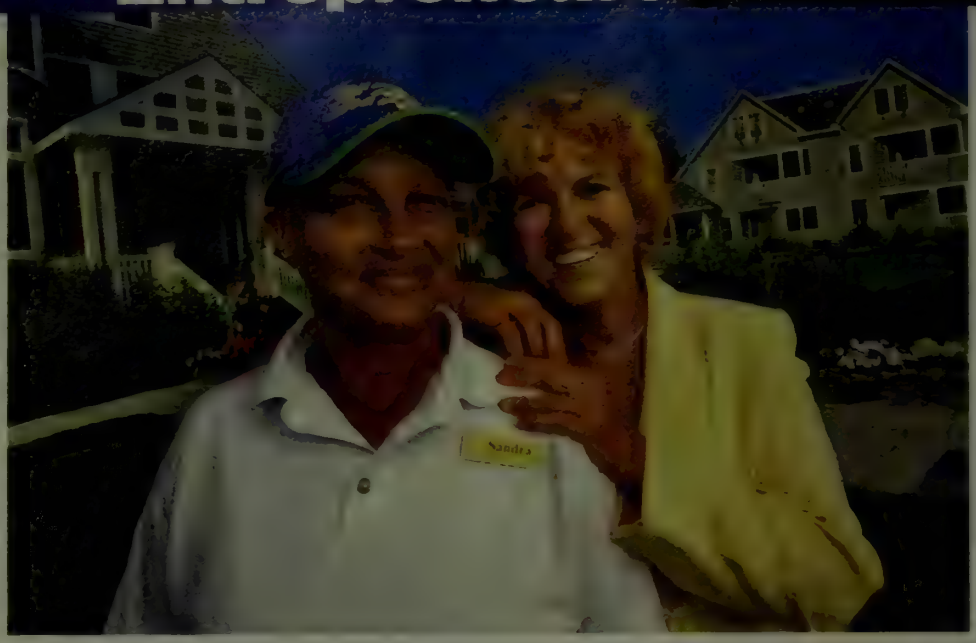
Removing sulfur from diesel fuel is key to achieving dramatic emissions reductions, similar to the clean air advances removing lead from gasoline allowed. By the beginning of 2007, ultra-low sulfur diesel (ULSD) fuel – with a sulfur content of less than 15 parts per million – will be available nationwide.

The Emissions Control System

ULSD enables a new generation of diesel exhaust control devices, like particulate traps and oxidation catalysts, to further reduce emissions from diesel engines by over 90 percent.



EPA emissions reductions of oxides of nitrogen (NOx) and particulates (PM) (g/brake/horsepower-hour) in commercial trucks and buses



GOOD TIMING Tibbetts and McQuade got coverage just in time

They've Got You Covered

New state partnerships help make insurance affordable for small business

FOR 15 YEARS, MAUREEN McQuade struggled to get health insurance for the 19 employees of her Inn by the Sea in Cape Elizabeth, Me. But there were always some workers—seven in 2004—who couldn't afford the premiums.

That's why in January, McQuade signed up for DirigoChoice. Dirigo is the result of a June, 2003, state law that aims to extend health insurance to all Mainers. Insurance is provided by a private company but negotiated by the state. To participate, employers must pay 60% of their workers' premiums. The state subsidizes premium payments for those earning less than 300% of the federal poverty line.

Because Dirigo is cheaper yet more generous than McQuade's old plan, both she and her employees come out ahead. One staffer in particular: Sandra Tibbetts, a housekeeper, was diagnosed with breast cancer during a June checkup. It was the first time she had seen a doctor in years. She's now receiving chemotherapy, and her prognosis is excellent. "I am delighted that no one has to go without health care," says McQuade. "But I had no idea that the stakes could be so high."

Dirigo is one of a slew of new state programs trying to help small companies provide health insurance for their workers. Since 2004, at least nine states have started new programs; four more plan to in 2006. It's not the first time the states have stepped in where the feds fear to tread: These programs build on an earlier wave of public-private partnerships that debuted in the late 1990s. States have learned some crucial lessons. Financial incentives are now bigger, and paperwork is minimal. States are working closely with agents and brokers who sell to small companies.

Despite successes in Maine, Arizona, and New York, some small business advocates remain skeptical. "These remedies may not be sustainable because they don't address the fundamental problems in the small-group marketplace," says Jamie Amaral, national director of health research and development at the National Federation of Independent Business. Amaral worries that as employers rely more on plans like Dirigo, the programs will become overwhelmed, requiring more funding.

The resurgence of state interest has been years in the making. Early in his first term, President George W. Bush authorized the Health Insurance Flexibility & Accountability (HIFA) initiative, which let states redirect Medicaid money to cover the uninsured. Now some states are using the waivers to aid small-company employees. Another lift came from 51 Health Resources & Services Administration grants given since 1999 to help states fund research of their uninsured. Then there are fatter state coffers: The major impetus to create a small-business insurance pool in Delaware was the surprising "discovery" of hundreds of millions of tax dollars at the beginning of 2005.

BARE ESSENTIALS

STATE INSURANCE PROGRAMS tend to fall into a few categories. Like Maine, West Virginia negotiated with private insurers and came up with its own small-business insurance plan. Kentucky is allowing the sale of basic plans lacking previously mandated benefits. Community-based programs, such as those to be rolled out in several regions of Georgia next year, split the cost of premiums about equally among employer, employee, and state and local government.

As of July, 2004, Healthcare Group of Arizona, a state agency, has been offering small companies three types of plans from comprehensive to bare-bones. Kimberly Howard, co-owner of Arizona Fire Protection, a $2 million Peoria (Ariz.) company that installs sprinklers, signed up with the Healthcare Group in August 2004. Employees need six months' tenure to participate, making nearly two-thirds of Howard's workforce, then numbering 22, ineligible. "Without health insurance, it's tough to get people to stay," she says. Her three execs chose the comprehensive plan. The other workers chose the bare-bones option, with a monthly premium of $95. Howard pays half the premiums. She hopes the plan will persuade her other workers to stay around a bit longer, solving two big problems at once. ■

—*By Joshua Kendall in Boston*

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Managing Google's Idea Factory

Marissa Mayer helps the search giant out-think its rivals

IN LATE 1998, WHEN MARISSA Mayer first heard about a small outfit called Google, she barely batted an eye. The Stanford University grad student was urged by her adviser to pay a visit to two guys on the computer science building's fourth floor who were developing ways to analyze the World Wide Web.

But Internet startups were as common as hay fever in Silicon Valley. Mayer, then 23, was leaning toward taking a teaching gig at Carnegie Mellon University. And the thought of joining up with the university's techies wasn't exactly appealing. "I knew about the Stanford PhD types," she muses. "They love to Rollerblade. They eat pizza for breakfast. They don't shower much. And they don't say 'Sorry' when they bump into you in the hallway."

Fortunately for both Google Inc. and Mayer, she had a change of heart. A headhunter persuaded her to reconsider the search startup, and she ended up joining Google in early 1999, as a programmer and roughly its 20th employee. Since then, Mayer has emerged as a powerful force inside the high-flying company. Her title, director of consumer Web products, belies her power and influence as a champion of innovation. Mayer has her hands on virtually everything the average Google user sees—from the look of its Web pages to new software for searching your hard drive. And she helps decide which new initiatives get the attention of the company's founders and which don't.

It's no small task. Co-founders Larry E. Page and Sergey Brin have long declared their mission is to "organize the world's information." Yet only in recent months has the staggering scope of their ambition come into full relief. Google is moving to digitize the world's libraries, to offer all comers free voice calls, to provide satellite images of the world, and perhaps to give away wireless broadband service to millions of people. Google really seems to believe it can make every bit of information available to anyone anywhere, and direct all those bits—whether text, audio, or video—through its computers before they hit users' brains.

ROCKET RIDE

MAYER DOESN'T HANDLE all this herself. One of the key reasons for Google's success is a belief that good ideas can, and should, come from anywhere. Page and Brin insist that all engineers in the company have one day a week to work on their own pet projects. An ideas mailing list is open to anyone at Google who wants to post a proposal. What Mayer does is help figure out how to make sure good ideas bubble to the surface and get the attention they need. The task is becoming more complex as Google grows, with a workforce of 4,200 now and revenues on track to hit $3.7 billion this year.

It's increasingly important, too. Google's rocket ride has attracted a swarm of competitors, from giants Microsoft and Yahoo to upstarts like Technorati and Exalead. They're all aiming to take away a chunk of Google's search traffic, which puts a premium on the company's ability to develop other technologies. "People are used to typing in Google to search," says Chris Sherman, editor of the industry newsletter *SearchDay*. "But its competitors are doing a really good job of rolling out quality features and products." Microsoft Corp. has even explored taking a stake in America Online Inc. so that it can claim for itself the millions in revenues that Google gets from providing AOL with its search technology.

How Google Innovates

The search leader has earned a reputation as one of the most innovative companies in the world of technology. A few of the ways Google hatches new ideas:

FREE (THINKING) TIME
Google gives all engineers one day a week to develop their own pet projects, no matter how far from the company's central mission. If work gets in the way of free days for a few weeks, they accumulate. Google News came out of this process.

THE IDEAS LIST
Anyone at Google can pos thoughts for new technol businesses on an ideas m list, available companyw input and vetting. But be Newbies who suggest fan poorly thought-out ideas face an intellectual pum

BRIDGING THE GAP Mayer "is a geek, but her clothes match," says an ex-employee

The woman charged with helping come with Google's response is a tall, striking nde with blue eyes. At 30, Mayer still ries herself with the erect posture of the let dancer she was in her youth. She w up in Wausau, Wis., a city of 40,000 ut 3½ hours northwest of Milwaukee. aspires to live up to the example of her ndfather, who served as mayor of Jack-, Wis., for 30 years, despite being crip-d by polio as a child.

n Wausau, Mayer was one of the top aters on her high school team. Then brainy teenager decided to try out for n-pom squad and made that team, too. some who knew her, Mayer was king a point. "She wanted to smash the ge of the airhead cheerleader," says Jim Briggs, Mayer's high-school debate coach. Her debate team ended up winning the Wisconsin state championship; her pom-pom squad was the state runner-up.

A large part of Mayer's success at Google is due to her ability to travel easily between different worlds. When she first joined, the company had something of a high-school cliquishness, albeit in reverse. At lunch, the coolest kids—in this forum, the smartest geeks—sat together. On the periphery, sales and marketing folks gathered. Mayer could hold her own in either realm. "She's a geek, but her clothes match," says one former employee.

Mayer continues to bridge the gap between MBAs and PhDs. She helps decide when employees' pet projects are refined enough to be presented to the company's founders. Such decisions are often made through an established process, with Mayer giving ideas a hearing during her open office hours or during brainstorming sessions. Yet she is also good at drawing out programmers informally, during a chance meeting in the cafeteria or hallway.

During a casual chat in 2003, a worker told her about the project of an Australian engineer, Steve Lawrence. He was developing a program to track and search the contents of his computer, which ran on the Linux operating system. Knowing Google had to figure out a way for people to find stuff on their own computers, Mayer tracked Lawrence down and asked him about developing a version of his software to search any PC. He was enthusiastic, so she helped assemble a team to work with him. The result: Google introduced its desktop search in October, 2004, two months before Microsoft. "Marissa has been very successful as the gatekeeper for a lot of these new products," says Craig Silverstein, director of technology at Google.

Part of Mayer's challenge is realizing when certain formulas falter. For years she ran the company's Top 100 priorities list, which ranked projects by order of importance. But as Google's workforce grew, the list soared to more than 270 projects. Last year Google execs decided it had run its course, and shut it down. "People don't get attached to the processes themselves at Google," says Bret Taylor, product manager for Google Maps. "It's very unusual. Even at small companies, people tend to say: 'This is the way we do X.'"

Mayer's typical workday starts at 9 a.m. and doesn't end until about midnight. Her glass-walled office is intentionally situated across from the engineering snack area, where programmers grab evening coffee or munchies. Often on these late nights, engineers will bend her ear as they take a breather from their work, bringing her up to date on the countless ideas percolating through the ranks. "I keep my ears open. I work at

ICE HOURS
k to your professors' rs in college. That's ch what key managers, Mayer, do two or three eek, to discuss new e success born of ach was Google's zed home page.

BIG BRAINSTORMS
As it has grown, Google has cut back on brainstorming sessions. Mayer still has them eight times a year, but limits hers to 100 engineers. Six concepts are pitched and discussed for 10 minutes each. The goal: To build on the initial idea with at least one complementary idea per minute.

ACQUIRE GOOD IDEAS
Although Google strongly prefers to develop technology in-house, it has also been willing to snap up small companies with interesting initiatives. In 2004 it bought Keyhole, including the technology that let Google offer sophisticated maps with satellite imagery.

building a reputation for being receptive," she says.

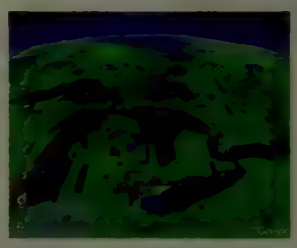
This theory is in action on a sunny Friday afternoon in September. Mayer walks around her office, shared with an assistant and two other employees. Outside the door, seven or eight programmers and product managers have been milling about since 3:30. Most wear jeans, tennis shoes, and checkered or striped shirts, all untucked. Some pace the hall and talk quietly on their cell phones. Others sit on chairs, their arms folded, waiting patiently.

OFFICE HOURS

AT 4 P.M., HER three-times-a-week office hours begin. It's a tradition Mayer brought over from her days at Stanford, where she taught computer science to undergrads. Over the years, such meetings have spawned some big ideas, including Google's social-networking site Orkut.

First to enter her office are a pair of techies—a man and woman in their mid-20s. Sitting across from Mayer, separated by a desk with a Dilbert coffee mug and a toy robot still in its box, they forgo the pleasantries and launch into hushed banter. The duo is stumped over which languages the Google Web site should be available in. Although it is already translated into more than 115 tongues, from Arabic to Zulu, they wonder whether they should proceed with more obscure choices. Before one minute elapses, Mayer interjects. Google shouldn't be the arbiter on languages. Just include anything considered legitimate by a third-party source, such as the CIA *World Fact Book*, she says. "We don't want to make a large geopolitical statement by accident."

In ones or twos, all the visitors get a brief hearing, typically five minutes. She gently rebuffs one group seeking to put a link to Hurricane Katrina information on Google's home page. The site for hurricane victims, she argues, isn't useful enough yet. She brainstorms with a product manager on how to measure and compare the freshness of Google's search results against its rivals'.



GOOGLE MAPS One big idea that bore fruit

One of the final groups marches in to discuss a personalized search product. Many pundits describe personalization as the Holy Grail in search. An engine that knows your preferences and interests intimately could tailor the information delivered to improve results. Google has been offering rudimentary personalization for a year, but more is expected in the future. With two people in Mayer's office and another on speaker phone, she grills the trio about the service's name. She's not enthusiastic about the initial suggestions. "You're killing me," she says.

After a few minutes of discussion, Mayer presses the group on the product's features. Google's top brass is having its next product-review session shortly, in whi nascent ideas get either fast-tracked sent back for further tinkering. So May asks the big question: "O.K., let's take it Larry [Page]. Are you guys ready to pro uct review tomorrow?" They assure h that they're set to go.

Office hours are just one way in whi Mayer connects with inventive enginee and managers. Another is Google's ide mailing list, the e-m thread to which anyone c submit or comment on idea. At times, the thre more resembles a form techie Darwinism. Goog newcomers who proffer especially obvious sugge tion ("Why don't we sear blogs?"), or something off-topic li how to arrange the cafeteria tables, ten suffer withering rebukes. "I about 50% new ideas, 50% indoct nation of new employees," says Mayer.

It's all part of a culture not for the fai of heart. Google oozes with what one employee calls "geek machismo." Intelle tual sparring can get heated. In the cafe ria, "food gets thrown," says the form employee.

What Mayer thinks will be essential continued innovation is for Google to ke its sense of fearlessness. "I like to laun [products] early and often. That has come my mantra," she says. She mentio Apple Computer and Madonna. "Nobo remembers the Sex Book or the Newto Consumers remember your average ov time. That philosophy frees you from fea

It's just one way Mayer tries to mainta the search company's original cultu That's no easy task. Movie night, for i stance, used to be a piece of cake wh perhaps 100 employees descended on a l cal cinema. Today, organizing such event is a full-time job. Yet Mayer handl several of these a year, from picking movie with the right geek cred (say, *S Wars: Episode III*) to ordering thousan of tickets to writing the software that l her track who has received them. "She s walks around with a laptop, handing o all the tickets beforehand," marv Google's Silverstein.

It makes sense for Mayer to stay in su close touch with the swelling ranks Googlers. She may need every one of th bright ideas to keep the search giant ahe of the competition. ■

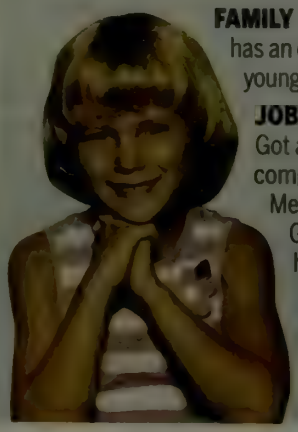
–By Ben Elgin in Mountain View, Cal

BusinessWeek online For a look at Google's home page design dilemma, go to www.businessweek.com/extras

BIO

Marissa Ann Mayer

This tireless exec is charged with keeping Google's innovation engine firing.



BORN May 30, 1975, Wausau, Wis.

HIGH SCHOOL Starred on the debate team and captained the cheerleading squad.

FAMILY Single, with no pets. She has an older half-brother and a younger brother.

JOB SHE TURNED DOWN Got an offer to teach computer science at Carnegie Mellon. Instead, she joined Google in 1999, when it had only 20 people.

KEY RESPONSIBILITIES Acts as a conduit between Google's legions of engineers and its co-founders, Larry Page and Sergey Brin. She guides the development of Google's consumer products, from its desktop search to personalized home pages, while also leading efforts to hire and groom scores of product managers.

ADMIRES Steve Jobs. All of her product managers are required to attend Macworld to see how Apple's CEO launches products.

CAFFEINATION Despite regularly working from 9 a.m. until midnight, she scorns coffee, indulging in just one Mountain Dew per day.

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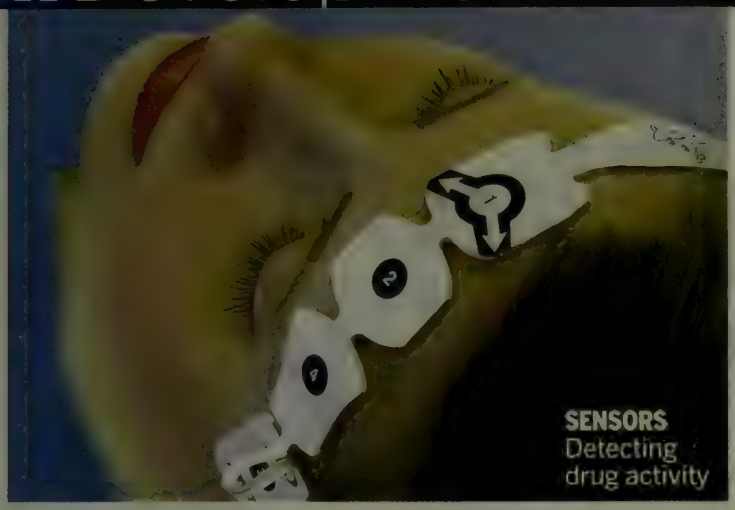
DITED BY
ATHERINE ARNST

NNOVATIONS

he gender divide, nd fighting stroke

The never-ending debate bout the differences etween men and women has een subjected to some cientific rigor—and it turns ut they aren't much different ter all. A meta-review of 46 rge gender studies over the st 20 years found that the xes are far more alike than fferent in almost all sychological variables and ental skills. Janet S. Hyde, a sychologist at the University Wisconsin in Madison, kamined how gender fluences cognitive abilities, rbal and nonverbal ommunications, social or sychological traits such as ggression and leadership, lf-esteem, motor behaviors, d moral reasoning. Gender peared to affect only rtain motor skills, such as e ability to throw a ball, me aspects of sexuality, d states of heightened ggression. Hyde's review pears in September's *merican Psychologist*.

People who are erweight typically have high vels of C-reactive protein RP), a molecule linked to a ightened risk of heart sease and stroke. CRP is oduced only in liver cells d blood vessel walls. But searchers at the University Texas M.D. Anderson ancer Center have found at fat cells produce emical signals that can igger the production of CRP. e good news: When fat cells e exposed to aspirin and olesterol-lowering statin ugs, CRP production clines. The report, based studies of cultured fat lls, appears in the *Journal the American College of rdiology*.



SENSORS
Detecting drug activity

DEPRESSION

READING BRAIN WAVES TO GET THE PRESCRIPTION RIGHT

PATIENTS WITH depression usually suffer through four to six weeks on an antidepressant before they can tell if it's doing its job, and that can lead to months of trial and error before doctors hit on the drug and dosage that works best. Aspect Medical Systems has developed a brain-wave reader that, based on early tests, could determine efficacy in a week.

Aspect CEO Nassib Chamoun says his device uses patented software to interpret signals picked up by an array of sensors strapped to the patient's forehead. Changing patterns in brain waves signal a drug's activity, if any. The Newton (Mass.) company is hoping to win marketing approval by the end of 2008.

The technology may have other uses. Boston Scientific, which owns 24% of Aspect, has given the company $25 million to determine whether it can detect Alzheimer's disease before symptoms are apparent.

–Michael Arndt

FIREFIGHTING

NOISE ALONE MAY QUENCH THE FLAMES

WILL SPRINKLER HEADS be replaced by audio speakers? It's possible, according to students at the University of West Georgia in Carrollton. Next month in Minneapolis, Dmitriy Plaks plans to wow the Acoustical Society of America's annual meeting with a report on his team's success in extinguishing flames with sound waves from ordinary speakers.

His paper will be tinged with mystery, however: He's not sure exactly how sound waves quench a flame. Plaks, a senior, says his Prometheus Project team needs to run more experiments and hopes to propose a theory next summer. So far, low-frequency sounds, ranging in intensity from an ambulance siren to a jet engine at take-off, are consistently effective.

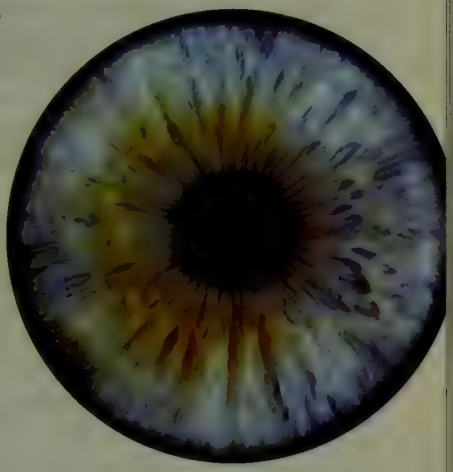
The research is currently aimed for use in spacecraft, where fire extinguishers are not effective. But the group is also thinking about earthly situations in which fire extinguishers and water might cause almost as much damage as a fire itself. *–Otis Port*

SECURITY

IRIS SCANS THAT WORK IN THE BLINK OF AN EYE

IN THE 2002 sci-fi film *Minority Report*, cameras in office buildings, train stations, and other public places keep tabs on people by scanning their irises from a distance. While a version of this technology is available today, its use is limited by the range and speed at which cameras can capture detailed images. Now Sarnoff is introducing a system that speeds up the process—potentially clearing the way for widespread use in security systems.

First-generation iris-scanning systems required individuals to stand 9 to 22 inches from the camera and hold still for 3 seconds. Sarnoff's Iris on the Move can identify 20 people per minute as they walk through a security portal. It can capture an iris as far as 10 feet away and within a wider range of view than earlier systems. The camera then hands off the images to a computer, which matches them against stored images in a database. Sarnoff says a few government facilities are currently using the scanners. *–Catherine Yang*



Can Wal-Mart Fit Into a White Hat?

After years of ignoring its critics, the giant retailer is embarking on a charm offensive

IN AUGUST, SEVEN MEDIA-SAVVY professionals from Edelman, a Chicago public relations firm, flew to Bentonville, Ark., for an unusual assignment. Although they remain on Edelman's payroll, the PR experts, some of them seasoned veterans of political campaigns, now run a new office deep in the headquarters of Wal-Mart Stores Inc. Dubbed "Action Alley," the office, and a similar one in Washington, D.C., acts as the nerve center of the world's largest retailer's campaign to soften its public face. Backed by Wal-Mart's own publicity staff, the team responds within hours to any new blast of criticism.

The troops also try to spin positive stories about the corporate giant. As they sat facing each other around three tables arranged in a U shape one day in mid-September, Hurricane Katrina was still high on the agenda. Action Alley had scored a bull's-eye after just weeks on the job when it garnered widespread national publicity about Wal-Mart's efficient relief efforts following New Orleans' devastation. Now the team was deep in follow-up, making press calls guided by talking points scrawled on the felt-marker boards lining the perimeter of the room: "EOC," for emergency operations center, which earned so much praise for coordinating the company's disaster response; "Associate stories," referring to the experiences of individual employees during the storm; and "donation-partnership," meaning stories about Wal-Mart's charity. Already, "we have had some great successes," exults Wal-Mart Corporate Affairs Vice-President Robert McAdam, who heads the new office.

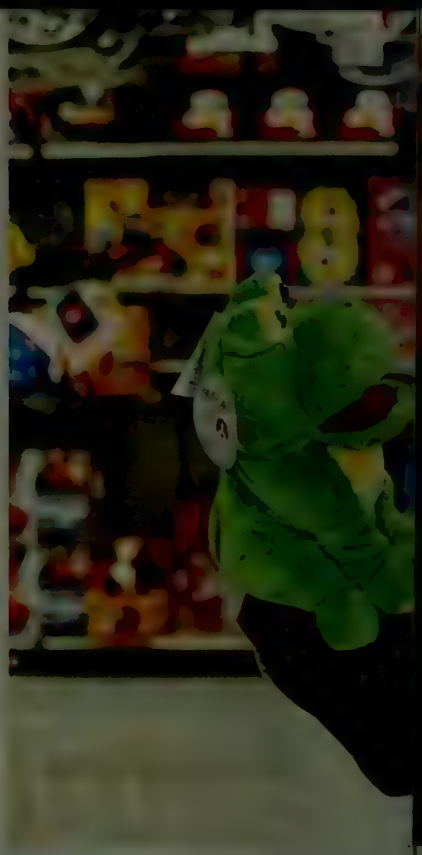
ON THE MARCH
Protesting Wal-Mart's labor practices

PAGE ONE

SPEAKING OUT

H. LEE SCOTT JR., Wal-Mart's tough CEO, is on a charm offensive—and how it plays out could change perceptions of the retailing leviathan at home and abroad. For several years, Scott shrugged off relentless criticism, but he now admits the broadsides on everything from labor practices to suburban sprawl were starting to inflict real damage. In fact, U.S. sales growth at stores open at least a year have fallen by half, over the past four years, to 3% in 2004. So this year Scott decided to speak out. "When growth was easier, this idea of critics simply being ignored was O.K. [But] as the share price slows, you have to get to this point," Scott told *BusinessWeek* at his Bentonville headquarters, where for the first time he discussed details of the company's outreach effort.

The outcome, he says, is the most comprehensive publicity blitz Wal-Mart has ever mounted. Early this year, the retailer launched a



Q&A

Lee Scott On Why Wal-Mart Is Playing Nic

In mid-September, Wal-Mart Stores CEO H. Lee Scott Jr. sat down with respondent Robert Berner at I tonville headquarters to discuss company's public-image campaign.

After long ignoring critics, Wal-Mart has started to reach out to them. Wh
When growth was easier, this ide simply ignoring critics was O.K. [Bu the share price slows, you have to g this point: Maybe not all of our cr wish us harm. So you start reaching to understand what is it about us causes them... concern. What is i need to change? What is it we can't? can't throw away things that are k your success. We as a company ha continue to evolve in how we op and how we interface with society.

WAL-MART'S NEW FACE
"The expectations of society changed"

Tell me about your packaging effort.
If you are large, every negative attribute that comes with being large naturally accrues to you. That is where something like [environmental] sustainability is a wonderful opportunity. As we do the right thing, we also have an impact across so many industries [and] countries. We are finding tremendous cost savings while doing better things for the environment.

Packaging is one of the simple ones, and shame on us for not having done it earlier. We just changed the packaging on 16 private-label toys. It saves 230 [cargo] containers [per shipment] coming from overseas, and we didn't change any of the product inside. I think we are going to find a lot of low-hanging fruit. In our energy management of our stores we have a number of things we will be talking about publicly over the next month or two.

Would you consider joining an anti-sweatshop organization that conducts independent monitoring of labor conditions in foreign factories?
We are actually looking at that now. We would like to make sure it's someone whose focus is really on those workers and not some other agenda.

When did you step up the contact?
We really started it last year, the visible part. But way, way before that I started having meetings with people who don't have a natural love for Wal-Mart, [such as] former Clinton White House people. Politicians who would meet me only in secret. Just dinners and lunches and private meetings. For the most part [I was] listening. I already know what I think. I want to hear what they think.

What made you turn outward?
You have board members who have different perspectives. We were getting nowhere the way we were doing it.

In Wal-Mart's history, you have never had an outreach program like this?
No. We always believed that if we sat here in Bentonville and took care of our customers and associates, the world would leave us alone.

So what changed?
The dot-com bust occurred, and companies weren't as celebrated as in the late '90s. Also, we got stronger in food, and it became apparent to people in the food business that Wal-Mart was going to be a capable competitor. The expectations of society also changed. At the same time, politics changed. Things became more bitter and divided. And Wal-Mart, because of our size, was in the middle.

Didn't the labor practices you were accused of add to that?
I think being in food and being so successful raised the profile of our labor exceptions [i.e., the lawsuits over work hours and immigrants].

You mean with the food workers union's interest in organizing Wal-Mart as it moves onto unionized turf?
Right. We had a CEO of a $30 billion company here three weeks ago talking to our management team, and he said: "There isn't anything you are faced with, from a class action to the rest of the stuff, that we are not dealing with. The only difference is that yours is played out on the front page of the paper, and you never read about ours."

You are dealing with environmental and anti-sweatshop groups. Why not set the standard in higher wages and benefits?
I think in many ways we are.

But you are always accused of paying rock-bottom wages and benefits.
Sure. On the other hand, at Wal-Mart you can, without a high school degree, start as a cart pusher in the parking lot and end up being a regional vice-president. That is a model. We are not building cars. We work in an industry where we compete with Target Corp. and Dollar General Corp. And we cannot [have] employment practices that set the standard for worldwide employment and forget the industry we are in. The jobs we provide are [the kind] people [take] to enter the workforce.

Why couldn't you pay above-industry wages, as warehouse club Costco Wholesale Corp. does?
The Costco model and their sales per square feet and revenue per store allow them to do the things they do. They have a different model—fewer people, a different customer base. That model doesn't work at Wal-Mart against Dollar General, Target, the Gap.

If you are forging ties with environmental and anti-sweatshop groups, why not reach out to unions?
I don't see any benefit to it. What I found in reaching out to other groups is that in most cases they would like Wal-Mart to be successful. I can learn from those people and learn where Wal-Mart can change to be a better company.

Will steps to be more environmentally sound and protect the rights of foreign factory workers change your low-cost business model?
That is what you have to be careful about. There are things that change your business costs. When it comes to the environment, there is so much we can do as a company that actually lowers our costs. This is the appropriate place to start because you are not trading off higher prices for this or that.

BusinessWeek online For an extended Q&A with Wal-Mart CEO H. Lee Scott Jr., go to businessweek.com/extras

NANCY NEWBERRY

national ad campaign about its corporate citizenship, sensing that bad press was undercutting the lure of low prices. Now, in addition to Action Alley, Wal-Mart has opened eight community relations offices nationwide to answer local criticism (table). It also has approached two environmental groups and will soon announce a major initiative to curb waste by reducing packaging. And it hired a nonprofit group to reach out to anti-sweatshop groups and improve monitoring of overseas factories. "We have to continue to evolve in how we operate and how we interface with society," says Scott.

What's not yet clear is how far-reaching the changes will be. The company lost a lawsuit alleging that supervisors forced employees to work off the clock and settled another about its contractors using illegal immigrants. But responding to other complaints could require costly changes to Wal-Mart's core low-cost, low-price business model. For instance, the company is still battling a massive class action alleging that it discriminates against female employees in pay and promotions. At this stage, Scott is adamant that Wal-Mart continue to focus on low costs to remain competitive with other discounters. "You can't be throwing away things that are the key to your success," he says. But Scott is all for image-enhancing efforts to broaden its appeal to affluent customers. And observers say that environmental and anti-sweatshop plans could help deflect criticism of other areas that are harder to alter, such as low wages and benefits.

The danger, of course, is that detractors will be inflamed all the more if they perceive Wal-Mart to be better at talk than action. "Their reputation in the area of trust has been slipping, and trust was probably their greatest asset," says Chris Ohlinger, president of Service Industry Research Systems, a market research company. He says consumer surveys show that the accumulation of negative publicity has contributed to sluggish sales growth.

Yet already, Wal-Mart is being prompted to change more than Scott expected when he started down the kinder, gentler path. When the company reached out to the Natural Resources Defense Council and Conservation International, talks centered on generally reducing its impact on the environment. But they quickly led to a concrete goal: Cut paper and plastics and save fuel by shipping more items on one truck. By reducing the packaging of 16 toys, Wal-Mart eliminated 230 cargo-ship containers.

This follows the July opening of an eco-friendly store in McKinney, Tex., soon to be followed by another in Aurora, Col. The experimental supercenter gets electricity from solar panels and wind turbines and heat from burning the motor oil left after lube changes and the fat used to fry chickens. The environment, Scott says, is where Wal-Mart, with its massive market size, can make a real difference. A greener Wal-Mart could also be helpful when facing opponents in places like California, notes Patrick McKeever, a retail analyst at SunTrust Robinson Humphrey.

PR to the Rescue

Wal-Mart has launched a major campaign to improve its sullied public image:

OUTREACH	Opened offices in eight cities, including New York, Los Angeles, and Chicago to improve community relations and counter local critics.
SHADES OF GREEN	Has held talks with two activist groups about adjusting its environmental impact. Is working with suppliers to cut down on packaging to slash paper and plastic waste and fuel costs.
WAR ROOMS	Set up quick-response teams in Washington and at Wal-Mart headquarters, each with half a dozen Edelman public relations firm staffers to respond to public criticism.
SWEATSHOPS	Hired Business for Social Responsibility, a nonprofit group, to help it establish relations with anti-sweatshop advocates and to bolster its global labor monitoring program.

Data: BusinessWe

SWEATING IT OUT

WAL-MART may find it a lot tougher to make progress on the sweatshop front. Last year it began working with Business for Social Responsibility (BSR), a San Francisco nonprofit, to reach out to groups active in monitoring overseas plants. The move came a year after Wal-Mart brought in a labor expert to expand its in-house global factory inspection program. The expert, Rajan Kamalanathuan, won respect from anti-sweatshop groups by setting up such system at Asda Group Ltd., a British gro cery chain with suppliers in low-wag countries that Wal-Mart bought in 1999

Kamalanathuan says the compan hasn't yet decided how far it will go. Fo years, critics have asked Wal-Mart to fo low Nike, Gap, and others by openin suppliers' factories to independent in spectors. Wal-Mart currently uses in house monitoring, which, critics sa leaves outsiders unable to verify reform

Wal-Mart's campaign bears strikin similarities to those undertaken by comp nies such as Nike Inc. A decade ago, whe the sneaker maker was first hit by swea shop allegations, for example, it tried quickly burnish its image and reach out moderate critics. But the dialogue soo forced Nike to take steps management ha long resisted, such as submitting supplier factories to random i spections by independen labor monitors.

Wal-Mart may well fo low a similar course. Th difference is that it has many more issues to de with, from sweatshops big-box criticism to labo unions. Still, "Wal-Mart at an early stage," say BSR President Aro Cramer, "and it's likel that they, like most comp nies that engage in the processes, will adapt the approach over time." ■

–By Robert Berner Bentonville, Ar

BACK TO SCHOOL A consumer mecca that's under fire

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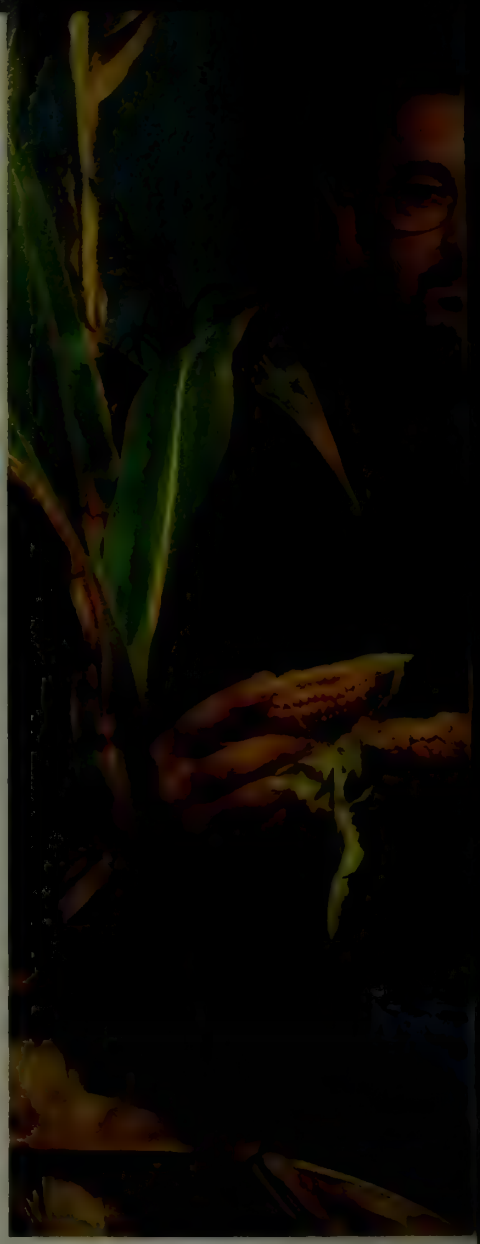
Blow After Blow for Midwest Farmers

Steve Pitstick is using high- and low-tech strategies to survive a cruel year



WHAT STEVE PITstick can do to manage the precarious business of farming he does. He attached a global positioning system to his combine so he can precisely map the output of the 2,220 acres of corn and soybeans he has planted across central and northern Illinois. His grain dealer sends the latest quotes for corn futures at the Chicago Board of Trade to his cell phone so he has as much information as traders do. And he spends hours a week at his computer, using Microsoft Excel to update production forecasts. But all this, he knows, is no protection against drought, high fuel prices or a devastating storm nearly 1,000 miles away.

Hurricane Katrina shut down ports along the Gulf Coast, through which nearly two-thirds of the country's grain exports are shipped. Eight of the 10 export facilities in the area are up and running but at nowhere near full capacity. Middlemen are reluctant to buy crops they can't move out quickly, so the price of a bushel of corn is roughly $1.65, 20¢ lower than usual. "There are buyers, but basically they want to steal it from you," jokes Pitstick, whose $750,000-a-year operation is typical of grain farms in the Midwest.

Making matters worse, Katrina has all but ensured that energy prices will remain high for a while. That's a major problem since fuel-related items accounted for about one-quarter of cash expenditures on Midwestern crop farms last year, according to the Center for Farm Financial Management at the University of Minnesota. And a summer-long drought has withered some of Pitstick's corn. "There is not much you can do when you have low grain prices and you end up with a low yield," says Corinne Alexander, assistant professor of agricultural economics at Purdue University. "That's possibly the worst-case scenario for farmers."

ESCALATING COSTS

PITSTICK WOULD NOT disagree. While the damage to farms along the Gulf Coast wasn't as bad as initially feared, and farmers in other parts of the country expect a good harvest, those in Illinois and Missouri are bracing for a lean year. Pitstick, for one, won't turn a profit. He's going have to rely on government subsidies and his insurance just to get by.

But nobody survives for long on the farm without plenty of old-fashioned ingenuity—and Pitstick provides a good ex-

Worst-Case Scenario

Katrina added to an already lengthy list of woes facing Midwestern farmers such as Pitstick. This year, he m have to rely on government subsidies and farmers' insurance just to break even. Here's why:

GULF DAMAGE
New Orleans' port

MESS ON THE MISSISSIPPI

Pitstick ships some 50% of his crops down the river for export to buyers in China and Europe. The backlog of barges has depressed grain prices by 10%.

RISING ENERGY PRICES

Fuel-related items are Pitstick's second-biggest expense behind land rental. He uses 200 to 300 gallons of diesel a day during the harvest, and natural gas is crucial to make the fertilizer he uses.

SUMMER-LONG DROUGHT

Pitstick had a bumper corn cr last year, producing 160 to 180 bushels an acre. He estimates this season some land may no produce anything.

PITSTICK Rains in August came too late to help his corn crop

ample of the mix of high- and low-tech solutions farmers in the Midwest are employing to deal with this season's crises. Since the Mississippi is congested with barges, he decided to delay selling his crops for a few months. And he's looking at all sorts of ways to cope with the longer-term issue of high fuel prices. "Farmers are by nature eternal optimists," says the 46-year-old Pitstick, whose brother raises hogs and whose father has a 1,000-acre farm down the road.

Not so the next generation, however. The deteriorating economics of farming have scared off his two sons. They help out on the farm but will most likely make their livelihoods elsewhere. The eldest works in construction management; the younger son just got a two-year degree and is considering further education.

The first move Pitstick made after the storm was to lock in January and February contracts for corn delivery that guarantee him $2.40 to $2.50 a bushel. And while he'll have to pay to store the corn until then, Pitstick figures he'll be better off than he would be selling now.

Adjusting to higher fuel costs hasn't been as easy. Pitstick uses 200 to 300 gallons of diesel a day to run his machinery during harvest time and depends on propane to dry his corn. Those prices have increased about 30% in the past year. Natural gas is the major component in manufacturing the anhydrous ammonia fertilizer he uses on his corn crops. Pitstick estimates that his fertilizer costs alone have doubled, to $70 an acre.

In response to these escalating costs, Pitstick has invested in the latest technology. The GPS on his combine allows him to create detailed maps that show exactly how much each acre produced; that, in turn, helps him decide how much fertilizer to use. The less corn an area produces, the less fertilizer the soil needs. "Forty or 50 years ago, you just dumped an equal amount of fertilizer in the area and hoped for the best," says Pitstick.

CUTTING CORNERS

PITSTICK ALSO HAS a new "no till" attachment for his planter that makes it possible for him to drive the machine across the land only once when putting in the crop instead of three to four times. But that doesn't soften the soil as much as the more intensive process, which could mean his yield is diminished. This year, more so than ever, Pitstick is trying to dry as much corn in the field as he can to save on propane. By doing so, though, he risks seeing the corn fall off the stalk or get eaten by insects or animals.

Some of his neighbors are thinking about growing more soybeans, since the crop requires less fertilizer. But Pitstick is unsure, in part because South American farmers are increasing their soy production, too. "It's all a balancing act," he says.

Then there are the things Pitstick can't do much about: the drought in Illinois and the good fortune of farmers in other parts of the country. Rain finally came in August, so his soybean crop wasn't damaged, but it was too late for the corn. Stalks that should be 10 feet high are barely 6 feet. Pitstick estimates that only his best acreage will yield as much as nearly all of them did last year, about 180 bushels. His worst won't yield anything.

It doesn't help that much of the rest of the U.S. may have a bumper crop this year. The U.S. Department of Agriculture forecasts that corn production will be 10.6 billion bushels—10% below last year's level but still the second-best year on record. "It's going to be really tough for farmers to break even in Illinois," says Philip Nelson, president of the Illinois Farm Bureau.

Pitstick is hoping just to meet his obligations: Like the majority of farmers in his state, he rents most of the land he farms. And he has to increase his operation by 5% to 10% each year just to keep his profit at the same level. That, too, is becoming difficult as urban sprawl claims more and more land. Much of the area around the 70 acres he does own, far outside of Chicago in Kane County, has been converted to a more profitable use—developments of $250,000 homes. ■

–By Adrienne Carter in Maple Park, Illinois

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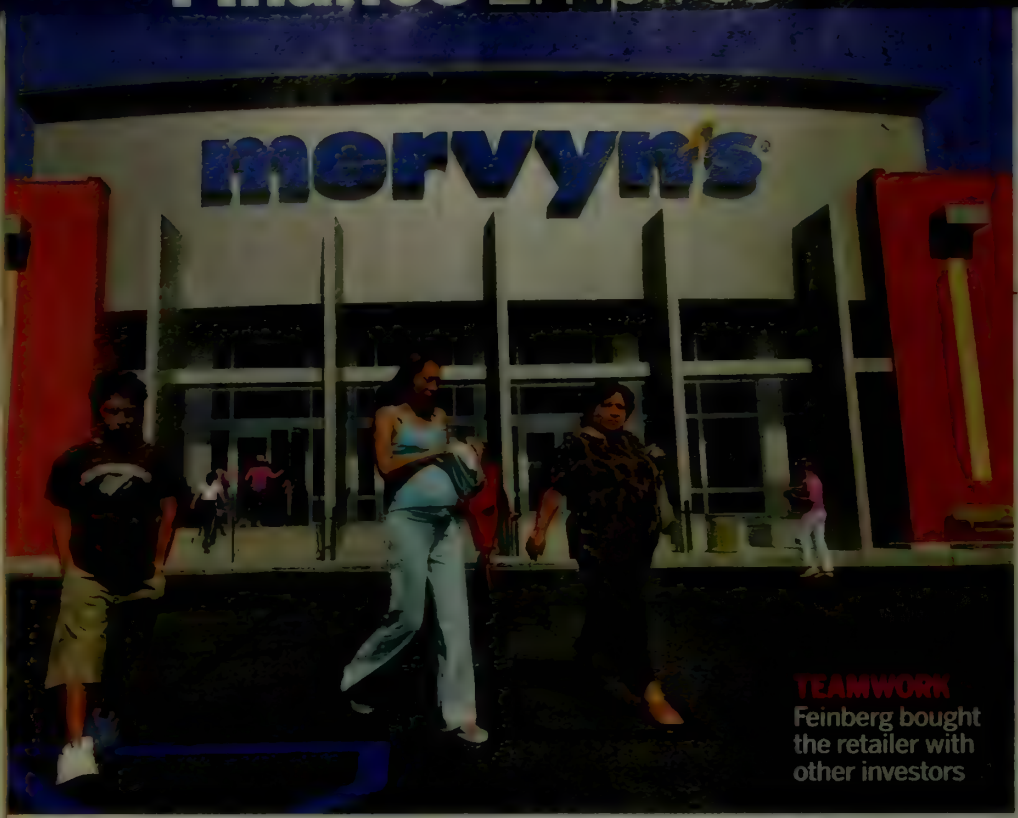
Q: WHAT'S BIGGER THAN CISCO, COKE, OR McDONALD'S?

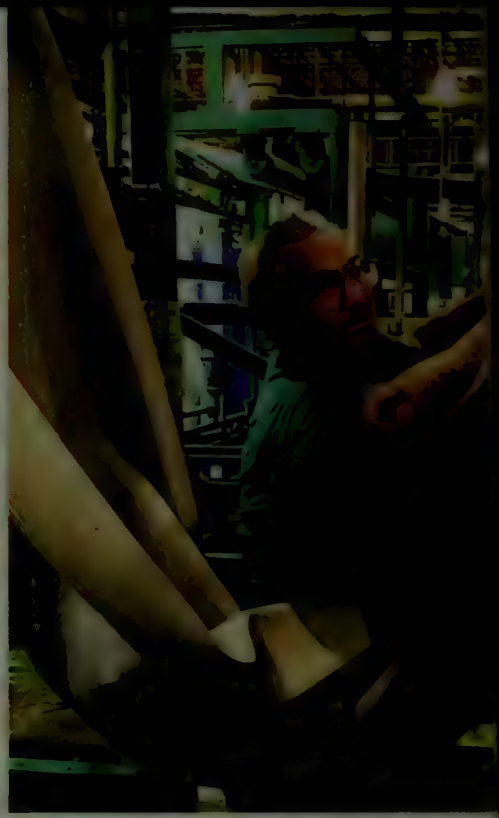
A: STEVE FEINBERG'S CERBERUS, A VAST HEDGE FUND THAT'S SNAPPING UP COMPANIES —LOTS OF THEM

BY EMILY THORNTON

SHARES OF ALBERTSON'S INC. WERE SOARING in mid-September on rumors of an impending bid for the Boise (Idaho) grocery chain. A pair of private-equity funds—giant pools of capital just waiting to pounce on takeover targets—had been circling, preparing offers that were said to top $16 billion. But then a new player showed up: hedge-fund group Cerberus. The Albertson's drama is still playing out. But even as Cerberus Capital Management LP pursues the grocer, it has been quietly discussing an offer for Morgan Stanley's aircraft-leasing business for up to $2 billion and negotiating for a big stake in Israel's second-largest bank, Bank Leumi. And it's still digesting a $2.3 billion purchase in May of Meadwestvaco Corp.'s paper businesses—a deal that included 900,000 acres of forest.



TEAMWORK Feinberg bought the retailer with other investors



Cerberus has been shopping up a storm for a year now, seemingly coming out of nowhere to build a corporate empire. With more than $16 billion of investors' assets on its books—almost double what it had in 2003—it has bought 28 companies and snapped up stakes of at least 15% in an additional 15 over the past decade. According to *BusinessWeek* estimates, Cerberus controls companies that ring up at least a combined $30 billion in annual sales, more than McDonald's, 3M, Coca-Cola, or Cisco Systems. With more than 106,000 employees, Cerberus companies have a bigger payroll than Exxon Mobil Corp. Its trophies include 226 Burger King restaurants, the National and Alamo car-rental chains, building-products maker Formica Corp., and the old Warner Hollywood Studios, where blockbusters such as *Basic Instinct* were made. Its companies connect BlackBerrys, provide medical therapy, and set up military-base camps in Iraq.

PICKUP TRUCKS AND BUD

THE MIND-BOGGLING RISE OF Cerberus—from a fringe vulture fund started with a grubstake of about $10 million in 1992 to a Wall Street powerhouse—has been driven by its enigmatic boss, Stephen A. Feinberg, 45. Like other hedge-fund managers and buyout kings, Feinberg has a penchant for secrecy, although his is more developed than most. While co-founder William L. Richter deals with investors, and lieutenants such as former Vice-President Dan Quayle jet around the globe to seal deals, the mustached Feinberg keeps very much to himself in a nondescript office on the 22nd floor of a high-rise on Manhattan's Park Avenue. The walls are bare save for a lone photograph of a motorbike that is propped up against his window; a black kid-size motorbike with training wheels—a gift from an outside adviser—is parked next to his desk.

The son of a steel salesman, Feinberg was born in the working-class town of Spring Valley, N.Y. He still describes himself as "blue-collar," even though he's a Princeton grad and took home about $50 million last year. "While other hedge-fund managers are collecting fine French wines and flying around in private planes, he drives a Ford truck and drinks Budweiser," says college roommate Jonathan Gallen, who runs his own hedge fund. Cerberus doesn't even have a Web site—and it doesn't reveal exactly which companies it owns. Feinberg declined to be interviewed or photographed for this story, but dozens of current and former Cerberus executives, investors, and associates spoke with *BusinessWeek*, many not for attribution.

However six-pack his origins, Feinberg now moves in rarefied circles. Defense Secretary Donald H. Rumsfeld was an investor in 2001, according to government ethics disclosures. Hedge-fund legend Michael Steinhardt is a shareholder and director in Cerberus' lending arm, Ableco LLC. Michael Dell's private-investment firm has joined with Cerberus and homebuilder Lennar Corp. to develop upscale residential communities on the former El Toro Marine Corps Air Station in Irvine, Calif. His roster of investors also includes public pension

Giant in the Shadows

Cerberus' voracious appetite is rapidly extending its reach into a broad swath of industries

SPORTSWEAR

» Rafaella Sportswear, New York-based women's apparel business, bought in May for an estimated $213 million.

» Fila, the Italian sportswear and footwear outfit, for $674 million in 2003

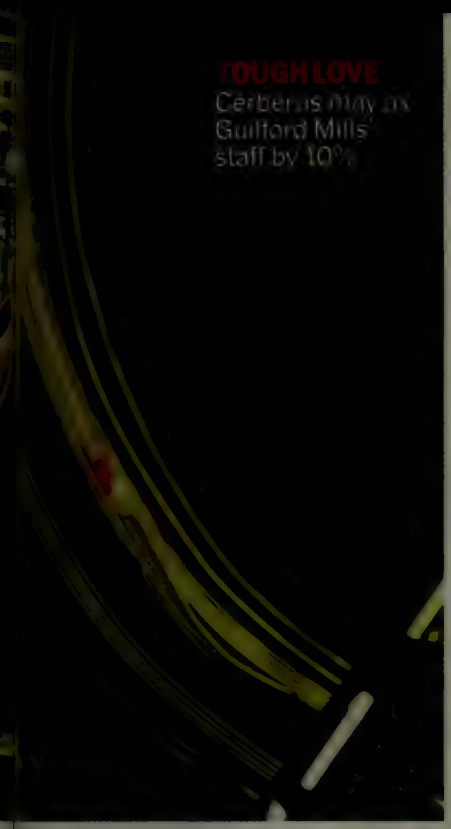
PAPER PRODUCTS

» Meadwestvaco's paper business. The $2.3 billion deal this spring included 900,000 acres of forest.

MILITARY SERVICES

» A division of Johnson Controls, bought by IAP Worldwide Services, a Cerberus company, in February to create a $1 billion military supplier.

(TOP L TO R) AXEL KOESTER; H. SCOTT HOFFMANN/NEWS & RECORD; AXEL KOESTER



TOUGH LOVE
Cerberus may cut Guilford Mills' staff by 10%

TWO FLEETS
National and Alamo cost $400 million

funds such as TIAA-CREF and the California State Teachers' Retirement System.

Feinberg likes to dream big. If he ends up buying Albertson's, he'll pull off the biggest deal by an investment firm since the storied Kohlberg Kravis Roberts & Co. purchase of RJR Nabisco Inc. for $31 billion in 1989. But to win, he'll have to beat out investor groups led by KKR and another buyout legend, Thomas H. Lee Partners, say bankers close to the deal.

This is a long way from traditional hedge-fund or even vulture-fund investing. In fact, Feinberg is breaking important new ground in the hedge-fund business. While many funds stick to a single, sharply focused strategy, Feinberg casts a wide net. Not content simply to trade securities the way other funds do or to assemble assorted companies for resale in the same way as many buyout firms, he's forging what looks more like an integrated industrial conglomerate than an investment firm. His secret weapon: a deep bench of 80 seasoned executives who troll the world for investment opportunities and stand ready to parachute in and run the companies he buys. Put all the elements together, says David M. Rubenstein, Carlyle Group co-founder and managing director, and "Feinberg may have perfected a new business model."

The Feinberg Way, like the methods of superfueled hedge-fund financiers such as Eddie Lampert and Wilbur Ross, has the potential to remake the corporate landscape as profoundly as the leveraged-buyout mavens, corporate raiders, and conglomerateurs did in earlier generations. With their access to huge amounts of cheap capital and ability to operate largely outside traditional markets—and the view of regulators—Feinberg and his cohorts could soon set their sights on even the biggest companies caught in a downdraft or struggling with change.

As befits a new kind of organization, Feinberg aspires to run the place more like General Electric Co. than a trading operation set up to turn a quick buck. In his search for best practices and economies of scale, Feinberg convenes as many as 100 of his investment pros and top managers at regular Monday meetings. They trade ideas, discuss ways to boost cooperation, and comb through each outfit's strategy. Among the regular attendees are such highfliers as Timothy F. Price, a former president of MCI Communications, and George E. Hamilton, who was an executive at Newell Rubbermaid and now runs several of Newell's old consumer-goods divisions that Cerberus bought and retitled Global Home Products. They also combine forces to win cheaper rates on everything from overnight deliveries to ink-jet cartridges by putting group-wide supply contracts up for bidding online.

This elite corps of managers examines potential deals, performs due diligence on loans that Cerberus makes, and sits on Cerberus company

AL ESTATE

ami Beach-based real estate developer Property, bought for almost $4 billion in uary. In July it filed to raise $750 million IPO of a real estate investment trust aged by LNR.

ERGY

l-and-natural-gas explorer Exco urces, bought for $335 million in 2003.

TAIL

ervyn's department stores, bought from et for $1.2 billion.*

ASSMAKING

nchor Glass Container, one of the d's largest glass bottle suppliers.

TRANSPORTATION

» Former DaimlerChrysler aircraft-leasing business, bought on Apr. 25 for an estimated $1.3 billion.

» ANC Rental, which operates the Alamo and National chains, bought out of bankruptcy in 2003 for about $400 million and renamed Vanguard Rentals.

BUILDING PRODUCTS

» Georgia-Pacific's building products distribution business in 2004. Cerberus took it public eight months later under the name BlueLinx Holdings.

» Formica Corp., building-products maker, bought last year.

*With other investors

Data: Dealogic estimates, companies

boards. Feinberg also expects his CEOs to bring him ideas for deals. Their incentive: a chance to run a company and get a chunk of equity. "With their operating experience, they help us identify both opportunities and problems we might not see," says Cerberus Chief Operating Officer Mark A. Neporent.

A NOVEL APPROACH

NONE OF HIS RIVALS have attempted integration on such a wide scale before. Other firms sometimes hire CEOs to run companies they buy, but never so many. Nor do they have them work so closely together or with the investment pros back at headquarters. Executives who run companies owned by KKR, for example, rarely, if ever, meet formally.

Feinberg has been equally innovative when it comes to financing. In 1996 he started Cerberus' own finance company, and in 2003 added a bank in Japan, Aozora Bank, making him a sizable lender to his own companies, as well as others. That means he can brandish his checkbook to clinch deals, while even well-heeled rivals often must scramble to line up financing.

Certainly, Feinberg's novel approach is producing healthy returns. Last year his biggest fund, Cerberus International, earned 15% after fees, having gained 22% in 2003, according to hedge-fund trade magazine *Alpha*. Because of the complex strategies he follows, the 12 funds Feinberg runs defy conventional categorization: Each is a heady cocktail of loans, real estate, debt instruments, and other investments. Some allow investors to take money out with just six months' notice, while others have lock-up periods of up to 12 years. Likewise, some are priced every month based on the market value of their investments; others are repriced just twice a year. All are now closed to new money.

Skeptics question whether a firm that long specialized in the debt of troubled companies brings the right management skills to outfits that make everything from picture frames and car seats to enterprise software and sports apparel. "Acquiring assets in all industries and selecting good managers, without any background at all in running companies, is insanely ambitious," says Bruce C.N. Greenwald, a finance professor at Columbia Business School. "When Warren Buffett goes into industries he doesn't know well, his record is substantially less successful for him. And these guys are not Buffett."

BIO

Stephen A. Feinberg

A secretive hedge-fund operator who's now intent on building a conglomerate of first-class companies

AT PRINCETON 1982

FEINBERG Circa 2003

BORN Mar. 29, 1960, in Spring Valley, New York

EDUCATION B.A. in politics from Princeton University in 1982. Senior thesis was on the legalization of prostitution and drugs. A member of the Reserve Officers' Training Corps, he jumped out of airplanes as part of his training.

CAREER CEO of Cerberus Capital Management since 1992. Got his start at Drexel Burnham Lambert.

HANGOUTS He lives in an apartment on Manhattan's Upper East Side. He also has a home in Stamford, Conn.

SELF-IMAGE He took home an estimated $50 million last year, but often describes himself as "blue collar."

OBSESSIONS He drives a Harley-Davidson motorcycle and a Ford F-250 pickup truck.

HOBBIES Hunting, chess, and skiing

POLITICS In the 2003-04 election cycle Feinberg and his wife sent a total of $114,000 to committees that work to elect Republicans to Congress.

FAMILY Wife Gisela, three daughters

True enough, Cerberus has had some big disappointment Of the four companies it has taken public while retaining co trol, two have stumbled. Building-materials wholesal BlueLinx Holdings Inc. has gone nowhere from its initial pul lic offering price in December, despite the housing boom. F more embarrassing, Anchor Glass Container Corp., whic makes bottles for Budweiser beer, filed for bankruptcy prote tion in August after being hit by a combination of accountin mishaps, rising natural-gas prices, and slumping bottled-be sales. Now, Cerberus is facing a class action from Anchor shar holders alleging it hid the loss of a contract from one of A chor's biggest customers just before its 2003 IPO. Cerberus file to dismiss the suit, denyin the allegations and arguin that it didn't oversee A chor's day-to-day busines Cerberus' financing strateg sometimes means that it doubly exposed when business doesn't pan ou Anchor has a substantial re volving-credit agreemen with Cerberus' Madelein LLC lending arm. Feinber has taken each of these flop personally. "He is brutal o himself," according to a pe son close to him.

But Feinberg also hits lot of homers. The stock c SSA Global, the softwar outfit that Cerberus bui through acquisitions, ha soared 41% since it wen public in May and no boasts a market cap of $1 bil lion. In July, Cerberus near doubled its money when sold a 66% stake in commu nication-services provide Teleglobe Internationa Holdings Ltd. to a division o India's Tata Group for $11 million. Executives at Van guard Car Rental USA, th umbrella for National Ca Rental and Alamo Rent Car that Feinberg bough out of bankruptcy two year ago for $400 million, told in vestors this summer tha they may eventually take the company public. Chicago-base researcher Spin-Off Advisors LLC estimates that if that hap pens, Vanguard could fetch $2 billion. In August the news tha Cerberus was merely eyeing $2.6 billion retailer Saks Inc. sen the stock up 10%; the shares sank when word spread that Fein berg was pulling out. Such clout wins him the esteem of hard nosed observers. "I find him to be quite intelligent," says leg endary tough-guy financier Carl C. Icahn (page 34).

Feinberg will need all the respect he can muster for the bat tle shaping up over Albertson's. Flush buyout firms and drug store chains such as CVS and Walgreens are swarming aroun the deal, undeterred by the grocery business' razor-thin mar gins. They like the chain's stable business, its substantial rea

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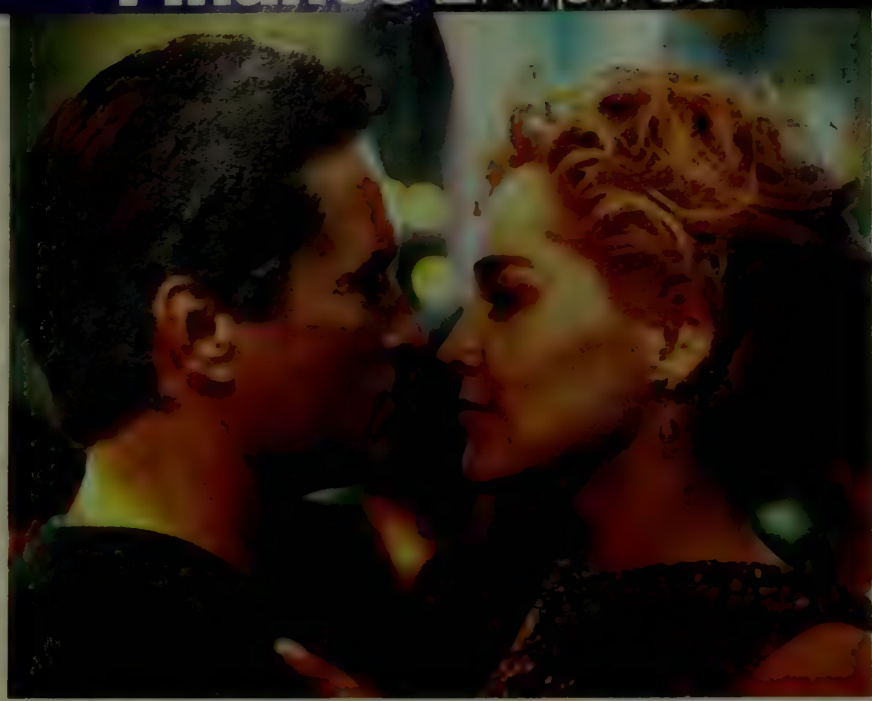

BASIC INSTINCT Cerberus owns the former Warner Hollywood Studios lot where the film was shot

estate holdings, or the opportunity to invest a big chunk of their funds in one shot. In the end, buyout firms might team up with corporate buyers to make bids, but battle lines will remain blurry as the firms pore over Albertson's books for the next several weeks before deciding how much to offer. For now, Cerberus has joined with real estate investment trust Kimco Realty Corp.

Feinberg may be weighing megadeals, but at least by the standards of Masters of the Universe, his tastes are unpretentious. He lives with his wife and three daughters in an apartment on the Upper East Side of Manhattan that cost less than $4 million in 1997. He also owns a 2,500-square-foot home in Stamford, Conn., that he bought in 1991 for around $500,000. To relax, he goes hunting, usually for pheasants and partridges on weekend trips to upstate New York with money-manager buddy T.K. Duggan. But last fall he raised the stakes by traveling to Colorado and scaling an 11,000-foot mountain in pursuit of bull elk. He felled the first one he saw with one shot, says Duggan.

When Feinberg was at Princeton it was far from obvious that he'd become a business mogul. He was brainy enough to beat classmates in games of chess but nervy enough to sign up for the Reserve Officers Training Corps, making jumps out of airplanes as part of his training in the Army's 82nd Airborne Division. By senior year, Feinberg was the captain of the tennis team, but not because he was a natural athlete. "He was a hustler," recalls roommate Gallen. "He wasn't the most talented player, but he had incredible willpower." He was also private back then: In his entry in the senior class directory, Feinberg mentioned Gallen as one of a handful of people who were his "few real friends."

Racking Up Returns

Three of Cerberus' four biggest hedge funds handily beat the average last year

FUND	RETURNS AFTER FEES	ASSETS (BILLIONS)
Cerberus International	15.2%	$3.8
Cerberus Partners	18.5	1.3
Styx International	9.0	1.3
Styx Partners	10.3	0.7
Average hedge fund*	9.0	NA

*Not [illegible]

Data: [illegible]

Feinberg majored in politics, producing a senior thesis arguing that drugs and prostitution should be legalized. For the paper, he not only delved into theories about the appropriate role of government but also spent a summer interviewing cops, hookers, and pimps in New York City. Feinberg took the position to impress a professor who he perceived as liberal after receiving a bad grade arguing the opposite view in a paper the previous year, says a person close to him. Today Feinberg contributes to Republican causes. He and his wife Gisela sent $114,000 in the 2003-2004 election cycle to committees working to elect Republicans to Congress.

His first finance job was as a novice trader at Drexel Burnham. But he soon moved on to Grunt & Co., where he worked on the same floor as Steve A. Cohen, now a hedge-fund star who runs SAC Capital Advisors LLC. By 1992, when he was 32, Feinberg wanted to strike out on his own and teamed with co-founder Richter, who ran his own brokerage firm.

They named their firm Cerberus, for the fierce cious three-headed dog that guards the gates of Hades in Greek mythology. Feinberg liked the idea that one of the dog's heads was always on watch just as his firm would guard its clients' investments around the clock, says J. Ezra Merkin, managing partner of hedge-fund firm Gabriel Capital Group. Merkin—whose clients included university endowments and wealthy New York families—became Feinberg's partner in a number of funds and deals. "I thought he would be able to move from passively investing in securities to building a business and actively managing companies," says Merkin.

TOUGH NEGOTIATOR

INITIALLY FEINBERG FOCUSED on trading the risky debt of troubled companies. Often he ended up owning big chunks of them once they landed in bankruptcy court, earning a fearsome reputation as a tough-as-nails negotiator. Sometimes he made a killing by changing management and forcing improvements. He soon realized that he also could make money by lending directly to distressed companies at rates of up to 20%.

With his assets quickly growing, Feinberg pondered how he could deploy more capital. So he started buying small, struggling companies—sometimes outright, such as auto-parts maker Ganton Technologies Inc. in Sturtevant, Wis.—and other times with partners, as he did with apparel maker Esprit, now based in Hong Kong. Along the way, he went into real estate, buying several Marriott International Inc. hotels that Cerberus still owns.

But as he pursued more and more deals, he found that his hard-boiled image often scared off targets. Sticking with the name

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Cerberus—despite the pleas of bankers to change it to something less frightening—didn't help matters. Neither did launching a fund called Styx, named after the river that separates the living from the dead in Hades. Says an adviser who has worked with Feinberg: "When people hear that Cerberus is looking at a deal, they groan."

After the stock-market bubble burst in 2000, Feinberg tapped into the $1 trillion that surged into hedge funds. That enabled him to move beyond basket cases. He never makes hostile bids, instead targeting companies with willing sellers—and plenty of scope for his management SWAT team to do their job and boost value. Lately that has led him to snap up divisions shed by blue chips such as DaimlerChrysler and Bayer.

Feinberg's image has been softened somewhat in recent years, thanks partly to Quayle. A mutual friend, George Zahringer III, a senior managing director at Bear, Stearns & Co., introduced the two after Quayle dropped out of the 2000 Presidential race. Quayle agreed to work for Feinberg part-time and use his connections in Japan to clear the way for what became a 62% stake in Aozora Bank. Now, as Cerberus' chairman of global investments, Quayle goes to Japan and Germany at least five times a year each to "tee up eventual deals." He recalls: "I spent my first two-and-a-half years in Japan trying to convince my Japanese friends—the business community, the regulators, and the political folks—that we were not one of those vulture funds. It has now changed entirely."

Nevertheless, his firm's reputation almost cost Feinberg a big deal last year. With the parochial Canadian press giving Feinberg a hard time, Air Canada parent ACE Aviation Holdings Inc. feared that he might chop up the airline. So the ACE board chose a Canadian citizen—Victor Li, son of the Hong Kong megabillionaire Li Ka-shing—to buy a bunch of its shares. Then Li backed out after tussling with the unions. Feinberg came back after his team repeatedly emphasized that Cerberus wanted to help the carrier grow. He also agreed not to sell his 9% stake for at least two years. The reward: the value of his investment of about $197 million has risen by more than 70% in just under a year.

HUNGRY? With 226 Burger King outlets, Cerberus may profit from your appetite

Feinberg's mission to revamp companies, combined with his awareness that he isn't the right person to actually manage them, earns respect from veteran executives who might resent having a financial whiz kid involved in their decision-making. "You and I might have a bowl of soup for lunch, but he has a bowl of data," says Vanguard CEO William Lobeck. "He has a memory like a steel trap," says SSA Global's Michael Greenough. "This guy never takes notes. Yet four years later he will remember something granular in the company that I would know, and I'm thinking, 'Why would he remember that?'"

BULKING UP

IT'S NOT ONLY his smarts that enable Feinberg to attract and keep talent. Some of the top folks at Cerberus headquarters earn up to $40 million a year, says one insider who asked not to be named. Executives who run companies for Cerberus could land compensation packages of as much as $20 million a year—twice the average CEO salary.

The key to making Feinberg's strategy work, however, is to get his companies operating profitably year after year. To do that, Feinberg has bulked up some of them by making acquisitions. In March, a Cerberus-owned military supplier, IAP Worldwide Services, bought a division of Johnson Controls Inc. that transformed it from a $100 million supplier to a $1 billion one. After a similar maneuver, SSA Global Technologies Inc., an enterprise-software-applications and services provider, quadrupled its revenues, to $700 million. Four years ago, now-CEO Greenough hatched a plan with Feinberg to use Cerberus financing to gobble up eight software suppliers for $367 million.

But he also isn't afraid to take an ax to a company or dump an executive. Greensboro (N.C.)-based Cerberus textile manufacturer Guilford Mills Inc. informed the city's mayor in April that it plans to close a plant and lay off almost 10% of its workforce. At Vanguard, Cerberus turfed 35 senior managers and replaced them with just five new people as it relocated its headquarters from Fort Lauderdale halfway across the country to Tulsa.

Feinberg is a tycoon with an edge, even when he's jesting. Three weeks after he took over SSA Global, Greenough says, Feinberg called and said, "I think I'm going to close you down tomorrow." Greenough scrambled to change Feinberg's mind. "After about five minutes he said, 'I'm just pulling your leg,'" he adds. "He has almost a childlike sense of humor." Greenough got back at him months later when he told Feinberg that they lost a deal due to Feinberg's tardy response to

The Secrets, and Strengths, of Cerberus

Hidden Empire: Cerberus won't reveal which companies it owns, but *BusinessWeek* has put together a list of many of the secretive firm's holdings

Commentary: Why every company should have a hedge-fund guru on its board

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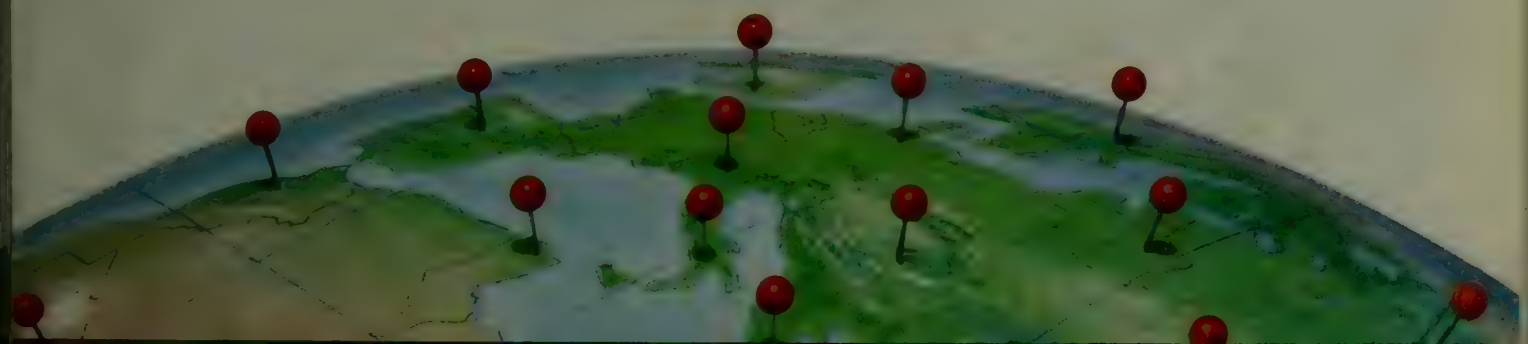

one of his messages. "He was speechless," Greenough recalls.

Feinberg shuns the social whirl of charity galas and opening-night parties. Last year he agreed to co-host a dinner at The Waldorf-Astoria in New York with the *Today* show's Katie Couric and GSO Capital Partners co-founder Douglas I. Ostrover to help raise money to fight Parkinson's Disease, which two of Feinberg's friends' fathers have, says a person close to him. Then he failed to show up. It turns out that while he agreed to lend his name to the affair and make a donation—he characteristically declined to attend.

That's no surprise. Feinberg's long hours leave little time f socializing. He puts in late hours in his office pondering p tential deals all over the planet and scrutinizing the myriad d tails of his far-flung empire. As interest rates rise, and the eco omy slows, more companies will find themselves on the rope This is exactly when Feinberg is at his best in his never-endin game of high-stakes poker. ■

–With Susan Zegel in New York, Joseph Weber in Chicag Lorraine Woellert in Washington, Hiroko Tashiro in Toky and bureau repor

DEALMAKERS

They're Not Telling Quayle Jokes at Cerberus

Dan Quayle, a smart-as-they-come businessman? The notion hardly fits with the image of the former Vice-President, who was mercilessly ridiculed by the press for the odd misspelling and occasional verbal slip. Friends long have argued that Quayle was unfairly scorched by Washington's klieg lights, but the public never warmed up to him. He dropped a Presidential bid and left politics in 1999.

Since then, in his second incarnation—as a globetrotting business leader working with some of the sharpest investors around—James Danforth Quayle, 58, has proved his friends right. He has carved out a winning role as chairman of global investments for Cerberus Capital Management.

Armed with a hefty Rolodex and a potent ability to get access, Quayle is the classic door-opener. He smooths the way for deals by gaining the confidence of sellers and regulators. Last spring he joked to executives of Cerberus companies that people have one of two reactions when he phones. As Air Canada Chief Executive Robert A. Milton recalls, "Reaction No. 1 is, 'Wow, it's the former Vice-President. Let me pick up the call.' The other reaction is, 'It's the former Vice-President. Why the hell is he calling me?" Either way, says Milton, Quayle gets a foot in the door.

He's especially valuable when offshore politicians are involved. It was Quayle, for instance, who met with then-Israeli Finance Minister Benjamin Netanyahu this summer about Cerberus' interest in buying Israel's 26.3% stake in Bank Leumi, Israel's second-largest bank. His first task after joining

USEFUL ROLODEX Quayle, with Japanese Prime Minister Koizumi, has opened many doors for the firm

Cerberus in 2000 was wooing Japanese officials nervous about the firm's bid for the former Nippon Credit Bank. His longtime ties to Japan paid off, and Cerberus eventually bought a controlling stake in the bank, now renamed Aozora Bank Ltd., in 2003. "Quayle has given a broad sense of credibility to Cerberus," says Yoshihiko Miyauchi, chief executive of Tokyo-based ORIX Corp., a financial-services provider that also has a stake in Aozora. "Having a respectable person like Quayle earns the trust of people who doubt the company."

Quayle also has shown a keen business sense as a company director, beginning in 1993, when he joined the American Standard Cos. board. "He surprised everybody in the most positive way with his insights, judgments, and ability to net out the issues," says Joseph S. Schuchert Jr., chairman of Kelso & Co., a private investment firm, and a fellow director.

Quayle once made what turned out to be a prescient call when he and the rest of the board rebuffed a takeover overture from Tyco International Ltd. in 1996. Wall Street had lavishly praised the potential combo, but Quayle was suspicious of Tyco's inflated stock price. Schuchert, whose firm controlled Standard, credits Quayle's "good common sense"—not any gimlet-eyed analyst's view—for sensing that Standard would be better off far away from Tyco. What's more, Schuchert adds, his "political skills were helpful in bringing the board together" to reject Tyco's approaches. And when Quayle and other directors on the K2 Inc. sporting-goods-company board were split on whether to keep an executive a few years ago, a colleague recalls, Quayle weighed in with the deciding question: "If we were going to hire for the position today, is this the guy we would hire? If he isn't, what are we talking about?" In short order, says K2 CEO Richard J. Heckmann, the executive was history. Quayle is still a K2 director.

Quayle says he hasn't found the transition from politics to business all that difficult. "There are a lot of similarities," he says. "You've got people who have different agendas. It's basically getting people to agree, and I've been doing that all my life in politics." But he admits it has been a learning experience: "I don't hold myself out as a financial expert, but I know a heck of a lot more than I did six years ago. What I do know is how to get things done." And at the rate Cerberus has been snapping up companies, apparently a lot is getting done.

–By Joseph Weber in Chicago, with Hiroko Tashiro in Tokyo

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Travel Loyalty Programs

Fall/Winter

Within days of Hurricane Katrina, executives at several travel loyalty programs like United Mileage Plus and American Airlines AAdvantage among others, had set up ways for program members to donate their points to the relief effort.

This creative application of points is a continuing trend in which travel purveyors are making rewards choices more flexible, faster and easier to redeem (often via the Web, and in hours or days rather than weeks or months) and much more attuned to customer preference.

An easy way to apply points toward humanitarian causes isn't the only new chapter in the loyalty game. Several industry giants have launched completely new programs or features that are transforming the way travelers can be rewarded for their patronage.

Boost the purchasing power of your points.

TripRewards® members now can exchange points and miles between disparate loyalty programs. Thanks to an agreement with Points.com, the rewards management portal, program members have access to more than 3,600 exchange opportunities and 270 point-redemption partners. And in the near future, TripRewards members will also be able to transfer points to friends and family members, and organizations will be able to purchase TripRewards points for distribution as incentives to customers, business associates, employees and charities. You can earn TripRewards points at the Super 8®, Days Inn®, Ramada®, Travelodge®, Howard Johnson®, Knights Inn®, Wingate Inn® and AmeriHost Inn® brands.

Also new is an Inter-Continental Hotels loyalty program that allows U.S.-based members of Priority Club Rewards, its customer loyalty program the opportunity to stay at "any hotel, anywhere." Priority Club Rewards members can redeem their points for prepaid lodging cards, which then can be used as payment at more than 500,000 lodging establishments worldwide.

American Express Corporate Travel has also unveiled a new loyalty program that targets the small- and mid-size business travel segment. This offering features a Webfare guarantee, which promises that American Express' online and offline offerings will match or beat any airfare available online. Also included is a new travel management loyalty program featuring double Membership Rewards® Points for individual travelers who book their trips with an American Express Card.

What works for the leisure traveler benefits the business traveler, too.

TripRewards® is the world's largest loyalty program, based on the number of participating hotels (6,000, from budget properties to high-end resorts). According to Jill Noblett, vice president of loyalty and direct marketing at The Cendant Hotel Group, it's also the first travel-related loyalty program geared toward helping leisure travelers get rewards faster, with fewer nights. "We found that the leisure traveler is a demographic that's been largely overlooked," she said.

The business traveler can benefit even more than leisure travelers from TripRewards' generous program simply by spending more nights in Cendant-franchised hotels.

The "open earn" structure of the program allows members fast access to point earning by staying in Cendant-franchised hotels, renting Avis® and Budget® rental cars and purchasing everyday products and services from program partners.

To earn TripRewards points even faster, sign up for the TripRewards MasterCard® affinity card. Participants earn 13 points for every dollar spent on qualifying hotel stays – 10 points for the stay, plus three additional points for using the card for that stay. All other purchases earn two points for every dollar charged.

TripRewards members may elect to earn TripRewards points, airline miles or rail points for their hotel stays. A hassle-free online system allows members to check points and redeem for rewards 24 hours a day. For more information, visit **www.triprewards.com**.

WRITER: Julie Moline is a business travel specialist and a frequent contributor to various consumer, trade and in-flight publications.

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HEADQUARTERS OF SOPHIA PROPERTY MANAGEMENT
The building on Paris' Champs Elysees is GE's largest purchas
$5.4 billion

GE: Globetrotting For Real Estate

New rivals and the frothy market are forcing its property unit to look overseas

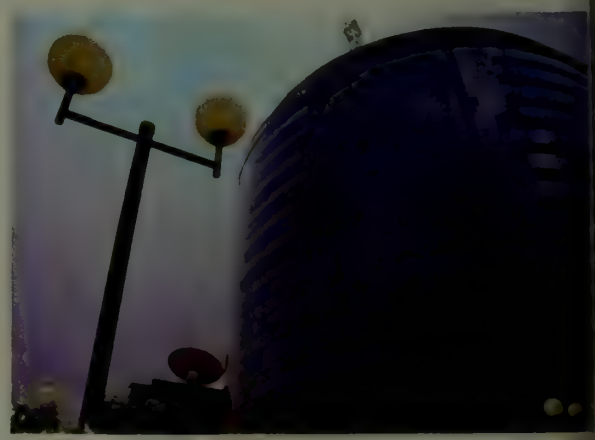
MEET THE WORLD'S biggest landlord, General Electric Co. Famous for lightbulbs and jet engines, GE has quietly built one of the most profitable empires of office buildings, shopping centers, and apartment houses around the globe. Last year the business, GE Commercial Finance Real Estate, earned more than a cool $1 billion on its 7,500 properties, part of a portfolio valued at $29 billion. That was seven times the profits at one of GE's largest public rivals, developer Sam Zell's Equity Office Properties Trust in Chicago, which held $25 billion in properties. Generating returns of more than 25% in each of the past 12 years, the real estate business now accounts for 7% of GE's bottom line. "Under the umbrella of GE, which is involved in so many businesses, we don't get a lot of attention," says Michael E. Pralle, the unit's chief executive since since 2000.

GE's real estate arm may get overshadowed, but the backing of a cash-rich parent comes in handy during acquisition sprees. That is, until lately. All the money sloshing into real estate these days is changing the game. "There was a time when the balance sheet was a weapon," says Mark Finerman, head of real estate finance for RBS Greenwich Capital. "Today, you'd better bring something more than just money to the tabl

So GE's Stamford (Conn.)-bas unit is increasingly shifting its fo overseas—especially towa emerging markets such as Inc China, and Eastern Europe—wh it believes there are better valu That squares with GE CEO Jeffrey Immelt's goal of eventually getti 60% of the conglomerate's reven from emerging markets. This yea is paring its North American ass from 54% of its portfolio to 47 Last year profits from outside t U.S. rose to 54% of overall earnin up from just 22% in 1999. "Our si gle biggest challenge is to grow, we have to get into new market says Pralle. "We are having to pu out of our very traditional stri zone." In all, GE will invest $16 billion real estate this year, most of it overseas now manages $35 billion in assets.

GE is far from alone in scouring forei markets for lucrative deals. Private-equ players such as Blackstone Group, Gol man Sachs' Whitehall Funds, and Lo Star Partners are jumping into overse markets. Still, GE, may have a big adva tage over its rivals: New players can have tough time breaking into new markets, e pecially without a network of contacts the ground. "There's a learning curve says Gordon F. DuGan, CEO of W.P. Car & Co., a New York investment firm th owns more than 650 commercial and i dustrial properties worldwide. "You ca just show up with a suitcase of money."

Back in the last real estate boom, G was primarily a big lender—and g burned. It wound up with $7 billion bad loans on its books when the frenzie market of the late '80s came to an en



BUSINESS TECHNOLOGY PARKS IN INDIA
Office buildings in Bangalore (right) and Hyderabad cater to IT outsourcing
$63 million

Ve got hit badly," recalls Pralle. "The al estate industry was on its back, and body had any cash."

Nobody, that is, except GE. The comny decided to become a buyer as well lender, scooping up shopping centers Florida, apartment houses in New sey, and office buildings in San Franco. The deals were often done for nnies on the dollar, but they added up some $2 billion. By 1993, GE was one the largest buyers of distressed real ate from the Resolution Trust Corp., government agency set up after the ings and loan debacle.

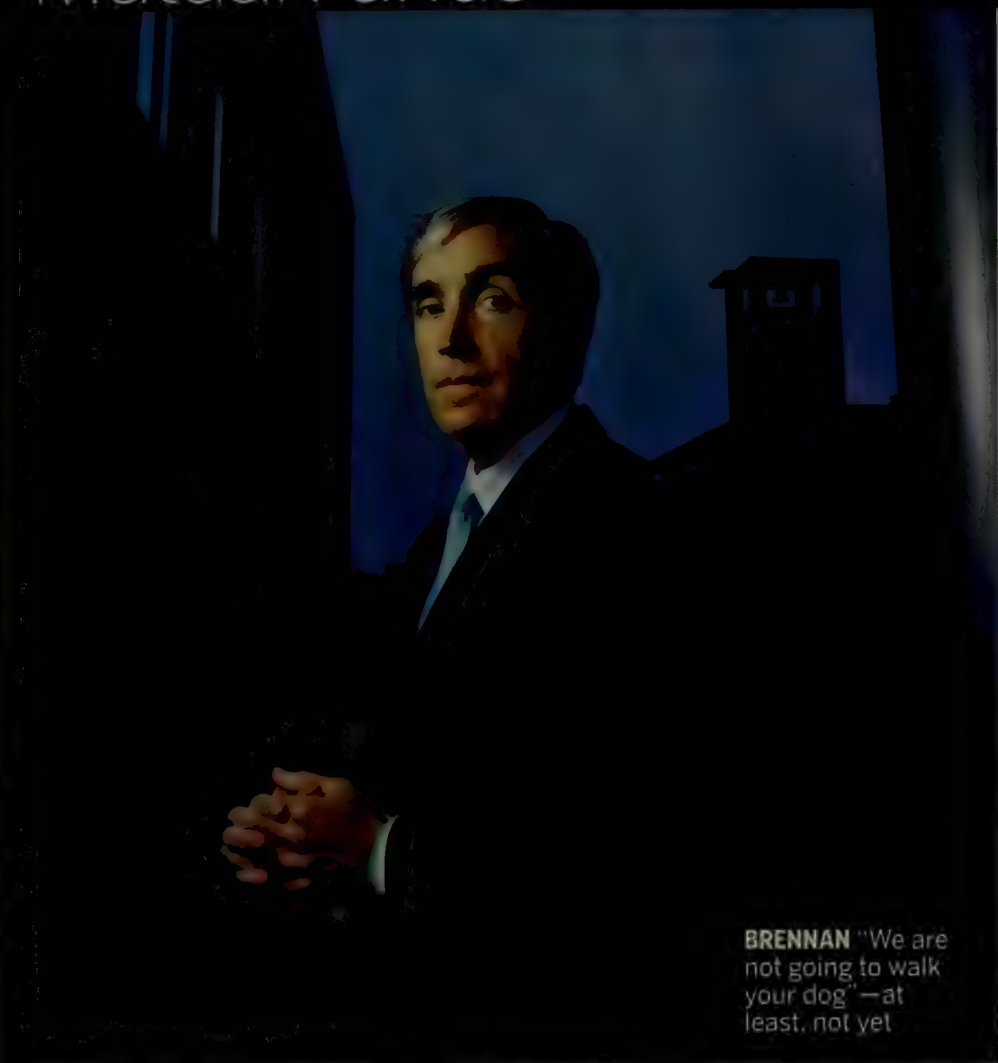
OPHY BUILDINGS

DAY, GE FINDS itself in a very differt market. Increasingly, it's elbow-tobow with flush hedge funds, privateuity folks, life insurers, and foreign estors, all hungry to diversify their rtfolios and bolster returns with h-yielding real estate. Sales of comercial properties valued at more than million, for example, totaled $187 lion this year through Sept. 1; in all of 03, only $130 billion in deals got ne, according to Real Capital Analyt- Inc., a New York real estate research n. "We're having a $100 million, troy-building-a-day kind of year in es," says Dan Fasulo, Real Capital's ector of market analysis.

GE avoids trophy buildings. Its aver- acquisition is only $7 million. And it en finds itself outmaneuvered on ger deals. In June, for example, GE t out to ING Clarion Partners, a unit Amsterdam-based ING Group, in a for Boca Raton (Fla.)-based Gables sidential Trust. ING Clarion sees bles' 20,000 apartments as ripe for do conversions, the hottest slice of commercial real-estate market. It d $3.6 billion, or $43.50 a share, ging out GE's $41 offer. "The other der clearly didn't value the business its potential and its land inventory," s ING Clarion's managing director, nk L. Sullivan, Jr. Says Pralle: "If neone has a differing view, we get bid. That's happening more."

Pralle concedes that some deals he s lost over the last five years turned to be good investments for the buy-. But he says that if GE made less ney as a result, so be it. "We won't e as much money when real estate rkets turn—and eventually they will n," he quips. Expect GE to have its ckbook ready when it does. ■

–By Mara Der Hovanesian in New York



BRENNAN "We are not going to walk your dog"—at least, not yet

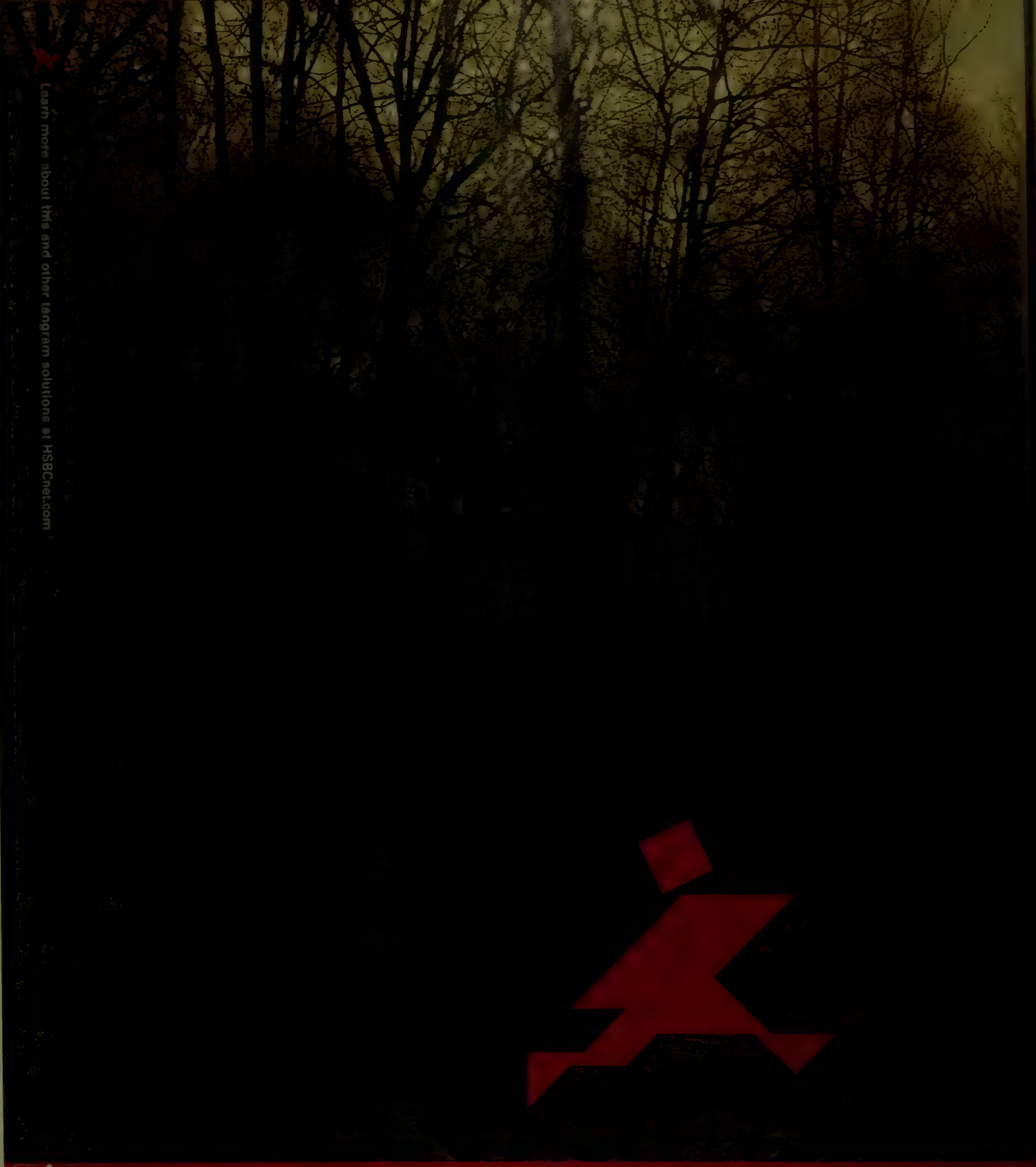
Vanguard Gets Personal

The fund giant is shifting its strategy as customers demand more hand-holding

FIFTEEN YEARS AGO, VANguard Chief John J. Brennan opened a letter from his dad, a newly retired bank executive. Enclosed was a check from his father's retirement account, along with a note that read simply: "Jack—Do something with this." Of course Brennan, then a senior executive at the mutual fund giant, was able to help. But, he remembers thinking, who was helping his father's friends and neighbors with such matters?

After years of catering to the do-it-yourselfers, Vanguard Group Inc. wants to be the one that answers those tricky questions for its clients. Brennan, who goes by Jack, is leading a quiet but significant adjustment in course at the fund company, which boasts $885 billion in assets. The Malvern (Pa.) outfit is developing a series of services, including new financial-planning programs for its retail customers, low-cost management services for participants in its 401(k) business, and offerings to help retiring boomers manage their accumulated wealth.

That's not all. Vanguard—known un-



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der founder John C. Bogle for taking regular jabs at the brokerage industry—is targeting those who hand their money off to brokers and financial planners by setting up a sales unit aimed in large part at peddling its fledgling exchange-traded funds, or ETFs. "Increasingly, people want advice, counsel, and hand-holding," says Burton J. Greenwald, president of mutual fund consulting firm BJ Greenwald Associates. "And traditionally, that has been anathema to Vanguard."

The 51-year-old Brennan insists Vanguard won't stray from its roots. "We are not going to open [retail] offices; we are not going to walk your dog," says Brennan."Clients are saying, 'I just want you to help me a little more.'"

MAJOR CHANGES

THERE IS CLEARLY a shift afoot in the fund business. The share of mutual fund assets that were held directly by retail investors dropped from 25% in 1998 to 19% last year, according to Boston-based Financial Research Corp., which tracks the fund business. The other 81% are held through financial advisers or institutions, including 401(k) programs. Certainly, that change hasn't yet hurt Vanguard: The company pulled in $25 billion in the first seven months of the year, second only to American Funds. Still, experts such as Greenwald note that investors are demanding more guidance, and Vanguard must address that need.

The company's most notable response is its effort to court brokers and financial planners. F. William McNabb III, managing director of the client-relationship group, created a new team of about 50 people 18 months ago to market Vanguard products directly to brokers and other financial advisers. The company also revamped its professionals' Web site earlier this year. Still, Vanguard is not as plugged into the brokerage firms as rivals Fidelity Investments and American Funds. And many firms, notably Charles Schwab, Fidelity Brokerage, and Ameritrade, are already well connected with independent advisers.

Yet Brennan argues that advisers are receptive to Vanguard's pitch. For one thing, more planners and brokers are moving toward fee-based compensation arrangements and away from commissions. That's why Brennan believes Vanguard's no-load, low-expense funds will be welcomed by fee-based advisers.

Lots of Advice

Long the home of do-it-yourself investors, Vanguard is going out of its way to meet a growing need for financial guidance:

» The company is mounting a big push with **financial planners and brokers** to sell more of its products, primarily its exchange-traded funds. In the booming ETF market, Vanguard is playing catch-up to Barclays.

» For **retiring workers,** the company will roll out a program called One Step Retire next year. Customers will be able to move their money into funds designed to generate the level of income they want, or to a program that will manage that money for a fee.

» The company will now individually manage **401(k) accounts** for participants in plans that it administers. One service: rebalancing the portfolio regularly as retirement nears.

» For **retail customers,** Vanguard is streamlining its financial-planning service and aims for an early 2006 launch. The current service has proven too costly and complicated for Vanguard to promote widely.

The focus on advisers also reflects Vanguard's need to play catch-up in the fast-growing exchange-traded fund (ETF) market. ETFs are index funds that are bought and sold on an exchange. It's an area that index giant Vanguard can hardly afford to cede: For the first eight months of 2005, ETFs accounted for 23% of equity fund flows, up from about 19% for the same period last year, according to AMG Data Services Inc. But Vanguard was late to market. Barclays' ETFs, known as iShares, have some 85% of the market, says AMG, vs. a 6% share for Vanguard's ETFs, called VIPERs.

Rivals such as Fidelity are more plugged in to brokerage firms

Closing that gap won't be easy. One broker, who declined to be named, says some of his colleagues are unenthusiastic about Vanguard's pitch, considering the company bad-mouthed the brokerage community for years. And Vanguard stopped providing back-office services to planners in 2003—a move that irked some of them. Vanguard execs acknowledge some planners and brokers may have been upset by past practices. But in general, they say, the company has strong ties in the adviser world.

In fact, Vanguard's efforts are starting to have an impact. Sheryl Garrett, who runs Garrett Planning Network Inc., an affiliation of 250 fee-only planners, says that until recently she h coached her advisers to u Barclays' iShares becau they have a wider variety funds. But after a visit fro a Vanguard representativ she now encourages them consider VIPERs more, part because they have lo er fees.

If Vanguard has a lo way to go in courting t brokers, it is also still findi its way in providing advice its own retail clients. Ni years ago, Vanguard roll out its personal financia planning service, where customers pay a fee $1,500 or less—dependi on the assets they have wi the company—for a on time financial evaluatio that includes everythi from insurance coverage retirement planning to co lege savings plans. But i labor intensive and more detailed th some clients like. No surprise, then, th the company with more than 5 million r tail investors only does 1,000 or so su plans a month. That's why it hopes to r out a version of the service in early 20 that will be less costly to offer and simpl for customers.

COMPETING ON PRICE

VANGUARD IS BETTER positioned to s advice to 401(k) customers. Just over on quarter of Vanguard's assets are linked these retirement plans. While the comp ny launched a service five years ago wi financial-technology firm Financial E gines Inc. that helps participants mana their retirement assets online, only abo 8% of 401(k) investors regularly use it. S Vanguard is rolling out a program und which the fund company will mana and rebalance an employee's 401(k) a count over time. The Vanguard progra will charge only 10 to 40 basis points, 0.1% to 0.4% of assets. Many competi services come with higher price tags, i cluding an offering from Fidelity that ca run as high as 65 basis points. That's w Fred Barstein, president and CEO of co sulting firm 401kExchange.com Inc., b lieves "Vanguard is in an extreme strong position."

Even so, the advisory business is n totally price-driven. To succeed, Va guard has to deliver premium advice the cut-rate prices customers expect.

–By Amy Barrett in Malvern, P

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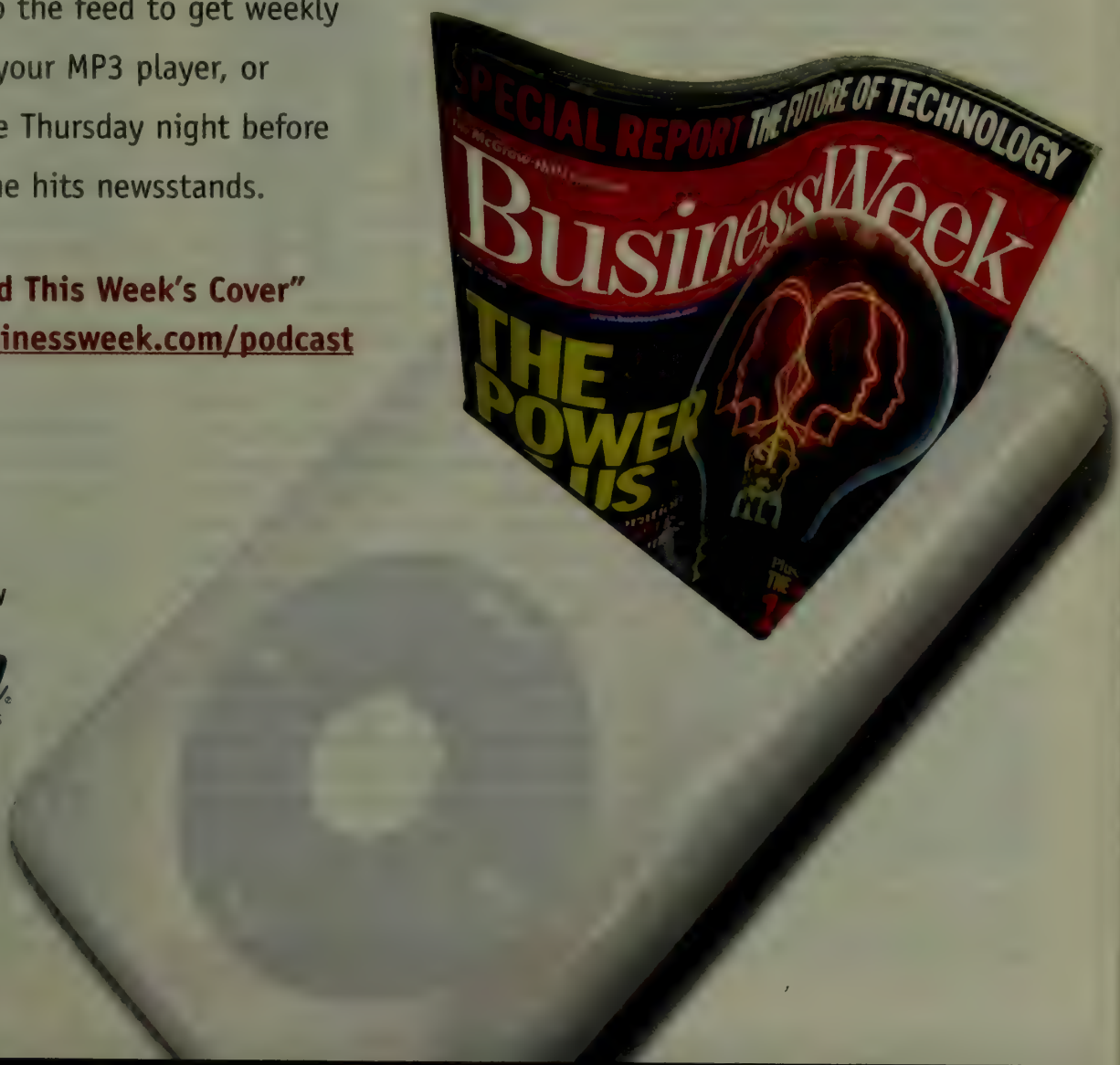

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The Benefits of Total Employee Mobility Management

Employee mobility has traditionally been thought of as a disconnected set of activities. Business vehicle management, travel management, corporate aircraft, technology to support the remote worker, relocation, and international assignments have not been recognized for their commonality: employee movement.

The magnitude of investment organizations are making to support a mobile workforce is significant. Companies can spend $25,500 per mobile employee per year on travel and entertainment, business vehicle, and communication/technology tools. And when mobility is required to fill a job vacancy domestically, the average corporation spends $51,700 to physically relocate one employee. The stakes are higher when sending an employee on a five-year international assignment, where organizations can spend $500,000 or more.

In comparison, most organizations have a solid handle on their employee benefits expenditures because this area is usually managed by a single function, Human Resources. The cost of a typical benefits package for an employee making $100,000 per year is $25,000.

Employee mobility program management is often dispersed throughout the organization, with pieces owned by human resources, finance, corporate travel, facilities, procurement, and IT. Additional complexity is added through fragmented outsourcing arrangements. As a result, top management cannot tell itself or the board what employee movement costs the corporation, how productive it is in managing employee movement, and whether it achieves an adequate return on investment.

By looking at employee mobility as a single, integrated responsibility, improvements can be realized in a number of areas. First, total employee mobility management allows an organization to streamline processes and reduce costs. For example, significant efficiencies can be gained when tangible items and corporate assets such as the company-provided vehicle, cell phone, corporate card, and other tools and equipment are managed and accounted for by one function rather than six.

"By looking at employee mobility as a single, integrated responsibility, improvements can be realized in a number of areas."

Employees too would be happier if they could receive answers to all of their mobility-related questions in a fast, efficient, and consistent manner. When an organization designs and manages its mobility program holistically, employee productivity is maximized.

Finally, viewing employee mobility in an integrated manner yields improved management controls, primarily because there is a systematic understanding of programs and areas where misunderstandings and abuses can occur.

Employee mobility is an expensive activity. Organizations that view and manage mobility in a more integrated manner will be ahead of the curve, yielding a competitive advantage.

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Personality Fit: The Key To Long Term Hiring Success

Successful long term hiring starts with iring practices. Most companies' hiring tandards filter for competency first, then ssess personality during interviews, nowing the best fitting candidate will ave the right combination of skills and ersonal style. Why, then, isn't personali- y given equal weight in the early stages f candidate selection? Considering only ompetency in initial candidate selection reatly limits the chances of finding a andidate with the right balance.

There are ten important steps in creat- ng a hiring formula that considers both ompetency and personal style together o find the best fitting person for long erm hiring success:

1. Assess the vacancy – Don't develop he job spec in a vacuum. Involve hiring nanagers, superiors, and subordinates. et ideas for increasing productivity, sat- sfaction and success. What skills are equired? What personal traits will be elpful? What strengths are already on he team? Which might be missing?

2. Translate input into skills and per- onality attributes that will enable ideas to e fulfilled. Personal style is half the quation, so make it an important part of he search, from the start.

3. Be realistic. Does the job spec escribe 'Super Candidate' who is every- hing to everyone? A strong leader and eam player? An analyst who quickly nakes tough decisions? Realize when raits conflict. Draw up a list and decide or sk others which competing traits are nore important.

4. Avoid rigid competency-based dis- ualifiers. Using them without consider- ng personal style renders a candidate list nbalanced and people who better fit the ersonal style to be overlooked.

5. Interview at least three times. Studies how long term placement increases harply with two and even more with three nterviews. Prepare for the interview by eveloping targeted questions designed pecifically to assess the personal traits and kills identified in the vacancy assessment.

6. Focus on the future. What a person might have done is not as relevant as what they need to do. Ask people from the department to think of real-life situations that this person might have to deal with and get a better sense of the true resource and style of the person. Ask specific situational questions that are relevant. Concentrate on a comparison with the true skills and personality traits the company needs and which the position requires, not on filling a predecessor's shoes.

7. Don't skip any part of the system. Especially if the candidate is a friend or co-worker. It's also important from a legal standpoint that the same process is followed with all candidates.

8. Implement follow-up success measurement. What was it about successful hires that made them so? Try to replicate and improve current tactics to enhance the hiring formula.

9. Think long term. Be willing to invest the extra time and effort in building a formula, and it will lead to a more effective, efficient long term process.

10. Document the hiring formula and build it into a system with specific steps and instructions. This ensures a legacy of hiring success, makes it possible to delegate that success, and avoids repeating past mistakes.

To read the full report, go to www.management-reports.com/ebullpen.asp

eBullpen.com, Pleasant Prairie, WI built the first employment website that matches job seekers to employers using 3 dimensions of compatibility instead of resumes: personality traits, job preferences of the seeker and job requirements of the position. Its website, www.ebullpen.com determines compatibility between what job seekers and employers are looking for automatically, and presents matches to employers in order of percentage match for immediate online communication.

eBullpen helps shorten the hiring process by quickly identifying people who are compatible with a job's profile, and because personality is included up front as an added filter, it helps find highly compatible people much quicker than resume and telephone screening do.

For job seekers, the system is like having the best matching jobs find them, spotlighting them to employers as a match more obviously than a resume would. It places the focus back on the individual rather than purely the resume, giving the job seeker a better chance of finding a job that fits their personality and search preferences. Over 12 years of research has gone into the personality model that the eBullpen matching algorithm is based on, including PhD validation of its matching mechanism. eBullpen's mission is to bring a powerful, accessible tool to employers and job seekers that will improve the hiring process and get the right people in the right jobs by making it easier and faster than ever before to find the right people.

Photos: Larry Zamba

Contact: Susan Govea • VP Marketing
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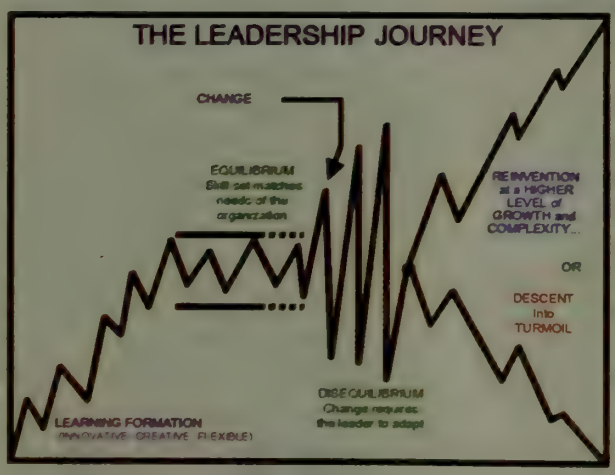
Coaching Leaders To Create The Future

The field of executive coaching is broad in style and focus with the common aim of creating more effective leaders. Today in many industries ever-increasing and unpredictable change dominates, bringing with it unimagined opportunities for a leadership team that is prepared to seize them.

There are executive coaches that specialize in developing leadership cultures that are capable of moving companies through continuous innovation as the marketplace demands adaptation.

World-class leaders in this often chaotic environment need to constantly reinvent themselves and their organizations. Skilled executive coaches can help leaders learn new ways of thinking and nurture new leadership habits to a point of sustainability.

Often learning new behaviors requires unlearning past thinking and behavior and seeing beyond our current paradigms. The role of any coach is to facilitate the leadership journey.



When facing complex change, even the most seasoned leaders can find themselves in a state of instability. During the continuous leadership learning journey, the state of equilibrium is short. There is a leadership learning curve followed by a short cycle of stability, then the business environment changes again and the system once more seems chaotic and unstable, thus requiring continuous growth in the leadership team.

Coaches help leaders hone their skills for strategic foresight by shifting the focus away from day-to-day events to preparing for a future state. This skill means focusing "on the system" rather than "in the system." Improving the whole system is a challenge, as there is a tendency to be drawn back into the day-to-day crisis within the system; a good coach keeps a leader on target. Keeping focus on the system requires discipline and commitment.

"World-class leaders in this often chaotic environment need to constantly reinvent themselves and their organizations."

Today's business environment is complex and uncertain.

What might be clearly visible to a skilled coach or consultant from outside the organization is invisible to those caught inside the complexity of the system. A coach often serves as an outside perspective for the leaders. This outside perspective is valuable in helping the leadership team see the emerging future and develop a culture of collective intelligence throughout the organization. Collective intelligence enables the company to be responsive and adaptive as the future unfolds.

Coaches facilitate growth of both individuals and the company. They coach leaders to develop healthy organizational cultures, structures and systems that sustain intelligent adaptive enterprises. They help leaders develop rigorous strategic thinking, foster cultural change toward collective intelligence, maintain the discipline to stay focused on the system and lead into a future state of success.

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The field of executive coaching has one key outcome: create more effective leaders. Since 1985 The Berrywood Group has been developing extraordinary global leaders. Leaders, armed with strategic foresight and ready to adapt to change prepare for the future. The group approaches coaching from a whole system point of view using state of the art assessment tools, in depth knowledge of how organizations work and how human beings operate inside those organizations.

With a team of executive coaches, The Berrywood Group teaches leaders strategies for thinking and nurturing new leadership habits. Through coaching, leaders develop the self-discipline to sustain those new habits. Global changes demand leaders that are capable of engaging the talents and commitment of all the people in the organization by building learning organizations.

Leadership, systems thinking, think tanks, Socratic methodology and the decision sciences are what the Berrywood Group is passionate about." A business system is made up of interrelated parts and people that to be healthy and profitable must understand and embrace a common aim" comments Dr. Barbara Berry president of The Berrywood Group. Moving organizations out of reactionary thinking allows for leaders to focus on future forecasting. A clear understanding of the complexity of the system equals more educated decisions, better planning and fewer surprises.

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Rank or Relinquish: Search Impacts Your Bottom Line

For too long, many large corporations ave ignored the role of Internet search in heir marketing plans. A recent study[1] evealed that only 13 percent of Fortune 00 companies have their web sites optinized for search engines. New data, dvancements in measurement solutions nd the seeming ever-presence of search ngine news in the media, however, is apturing the attention of corporate leadrship. Search has gained respect for its ow-cost, high ROI impact on the bottom ne and for transforming the game of cororate competition.

Fifty percent of all site visits originate rom search engines. Of all the search ngines, two are the clear forerunners: oogle, with 36.5 percent of all searches, nd Yahoo, with 30.5 percent[2]. Google sers are predominantly male (53.6 perent), Yahoo! female (50.2 percent), with oogle attracting the most visitors with ousehold incomes greater than 100,000. Ask Jeeves sent the greatest roportion of searchers (8.55 percent) to usiness-related sites[3].

There are two primary forms of search arketing: "organic" and "paid." rganic, or "natural" search, refers to the esults generated by search engine algoithms from their vast databases of web ages, e.g. the left-hand side of Google. atural search results are free. The rocess of affecting a site's natural earch engine results is called "search ngine optimization" or SEO. SEO nvolves implementing keyword-driven hanges to a web site to remove hinrances to search engine "spiders" that rawl the site. The impact of SEO takes me (up to six months) and is not a cerainty.

Paid search are advertisements, but up o 85% of searchers say they tend to nore the paid listings[4], so relying solely n paid search engine listings can have ramatically negative consequences.

Conversely, increasing a web site's natural search engine rankings through SEO has a direct impact on the site's traffic and ultimately the company's sales. Studies have shown that second or third page rankings can increase web site traffic by up to nine times. Top 10 rankings can mean an additional six-fold increase in traffic. The correlating impact on sales is also astronomical: 42 percent more sales within the first month of Top 10 listings and nearly 100 percent more the second month[5].

Search can also impact a company's competitive advantage. Many companies realize too late that their competition in a search engine may be completely different than their real world competition, and it's all a matter of who ranks higher. A relatively obscure company could see pronounced growth from top rankings while an industry leader, with a search engine unfriendly web site, doesn't even appear. Similarly, if a real world competitor appears in organic search and you do not, that competitor is certainly deriving a lion's share more business from the Internet. SEO can be used to offset negative search engine listings, i.e. listings for negative press coverage, lawsuits and resolved bankruptcies. Finally, a combined SEO and paid search strategy can also be used to brand and dominate for critical keywords.

Ignoring search can be detrimental to a company. Protect your bottom line assets by improving your search visibility.

Sources:

1 Oneupweb, May 2005
2 comScore Media Metrix, August 2005
3 Hitwise, August 2005
4 Marketing Sherpa, May 2005
5 Wired, February 2005

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Web Ad.vantage is a seven-year-old online marketing and advertising agency. Its core competencies include search engine optimization and paid search keyword campaign management, online media buying, and strategic consulting. Web Ad.vantage is particularly focused on direct response and lead generation strategies in five key areas: Awareness, Optimization, Conversion, Acquisition, and Retention. Clients turn to Web Ad.vantage to:

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Web Ad.vantage serves clients from many market sectors including corporations, non-profit groups and associations. Among its clients are Zurich Insurance, SafeNet, Blair Corporation, Nature Made Vitamins, Johns Hopkins University, Random House, Science Magazine, Baltimore Convention & Visitors Association, Long Fence and AMVETS. As an agency 100% focused on the Internet as a marketing channel, Web Ad.vantage works closely with clients' traditional marketing teams and web developers to ensure that emarketing initiatives dovetail with clients' off-line efforts.

The company's track record speaks for itself: Web Ad.vantage and its founder and president, Hollis Thomases, continue to receive client and industry accolades. The Maryland-based agency was selected by Forbes as a B2B "Best of the Web" for online media and advertising and has been featured on CNNfn, TechTV and in MarketingSherpa.com. An award-winning entrepreneur and bi-weekly columnist for ClickZ.com, Hollis Thomases was named one of Baltimore's "40 Under 40" in 2003 and was sole recipient of the 2002 Bush Declaration Award for Entrepreneurial Spirit.

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Medicare: Decisions, Decisions

/ith drug and HMO plans now in the mix, seniors face raft of complex choices. **BY HOWARD GLECKMAN**

IF YOU ARE 65 OR OLDER, you might want to buy a bigger mailbox. If you are the adult child of a senior, you better get ready to answer a raft of questions from your parents. Medicare is about to undergo profound change. Starting Oct. 1, seniors will be buried under a blizzard of advertising, all aimed at persuading them to buy new health insurance. ¶ Should they buy a Iedicare prescription drug policy? Should they enroll in an l-in-one managed care plan, called Medicare Advantage, that ill cover both drugs and other care now provided by tradi-onal Medicare? ¶ For health insurers scrambling to grab mar-t share in the nation's biggest untapped ivate insurance market, "it will be like e Oklahoma land rush," says Joseph An-s, a health economist at the American nterprise Institute. For seniors and their milies, the next few months will be a ne of both opportunity and confusion as ey struggle through conflicting claims d difficult choices. In the midst of the arketing cacophony, nearly 40 million niors and their families will have to de-le what to do. Joining the prescription an or Medicare Advantage is optional. If u are already enrolled in Medicare or st turning 65, you'll be able to sign up starting Nov. 15 through next May. Actual coverage begins on Jan. 1, 2006.

The biggest mistake seniors can make is to toss those ads in the trash. In the end, you may decide not to buy drug insurance. But think it through first. "Not making a decision isn't an option," says Kris Gross, director of the Iowa Senior Health Insurance Information Program.

Seniors will confront some complex choices. Gross's volunteers are getting 17 hours of training to learn about the new benefits. You can't take that course, but there are ways to make the process easier.

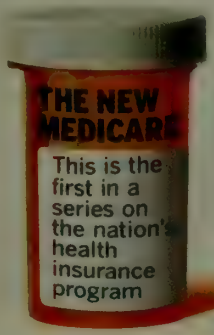
First, look for help. Medicare says you'll be able to compare plans on its Web site by mid-October, while state advisers such as Gross will be running community meetings and providing help by phone (table, page 126). Some programs you'll encounter may be run by insurance salespeople whose primary interest is selling a policy, not giving the best advice.

TOLERANCE FOR RISK

ONCE YOU GET the info you need, you'll have to decide whether to buy drug insurance. Seniors on Medicaid—often the case with nursing home patients—will be automatically enrolled in a no-premium plan. Those with annual incomes up to $14,356 for singles, and $19,246 for couples may qualify for a low-cost policy. By contrast, if you already have retiree drug insurance from your former employer, you may be better off sticking with it. You'll need to check that policy carefully to see how its benefits stack up with the new Medicare drug plan, called Part D.

For everyone else, it's a tougher, and much more personal, question. It will depend on your finances, age, health status, and tolerance for financial risk. For instance, if you are in your late 70s or 80s, and can afford the premiums, a drug policy is probably a good idea. If you are taking lots of drugs or have a chronic disease that may require more meds as you get older, buying a policy also makes sense.

If you are younger and not taking many drugs, you can delay enrolling. But you'll pay a penalty for that decision. If you don't buy by May, your premium will go up 1% every month you wait. With premiums running about $30, it will cost an extra $3 or $4 per month if you sign up a year later. "What is it Clint Eastwood asked? 'Do you feel lucky?'" says Stuart Guterman, director of the Program on Medicare's Future at the Commonwealth Fund, a New York think tank. "There are so many variables. It's a daunting decision."



If you do decide to buy drug insurance, you'll have to figure out which plan is best for you. Many seniors may be able to choose among a dozen or more plans. Some insurers will offer as many as three choices in the same market.

Congress designed a model

drug plan that carried a $35 monthly premium and a $250 annual deductible. It paid 75% of costs from $251 to $2,250, nothing for expenses from $2,251 to $5,101 (the infamous doughnut hole), and 95% for costs above $5,101. But actual policies may be different. Insurers can offer any plan they want, as long as its overall value is equal to that basic plan. Some may even eliminate all or most of that annoying doughnut hole. Remember, there is always a trade-off between premiums and out-of-pocket costs. Lower premiums mean higher deductibles and co-pays.

TOUGH CHOICES

DON'T JUST LOOK at price. You also need to know about formularies—the lists of specific drugs that are covered by a plan. If a drug that you take is in a policy's formulary, you may pay only $5 to fill a prescription. If it is not, you may have to pay full retail price—perhaps $50 or $100.

That means you'll have to make sure your drugs are in a plan. The choice gets tougher if some of your meds are covered by one policy while others are in a different plan. There is another catch: You must stay in your plan for a year, even if you change drugs or add prescriptions. So you will have to be sure that your doctor prescribes generics or the brand-name drugs that are covered by your plan.

Finally, you'll have to make one more choice. Do you want to stick with traditional Medicare or switch to a managed-care plan called Medicare Advantage? The government is giving insurers billions of dollars to create these new plans in an effort to wean seniors off the traditional program.

Most seniors are expected to add the new drug plan to traditional Medicare. Many will continue to supplement their Part A and B hospital and doctor insurance with a Medigap policy—private insurance that covers what Medicare does not, such as long hospital stays. By sticking with traditional Medicare, you'll retain a wide choice of doctors. But you'll be paying stiff premiums—$88.50 in 2006 for Part B, much as $200 month for Medig and $30 or so a mor for your new drug p gram. (Medicare rec ients will still get P A, which covers hos tal care, at no cost.)

BIG DRAWBACKS

A MEDICARE Adva tage plan may be mu less expensive. In sor states, your drug bene may be free, at least f 2006. Plus, you wo need Medigap, since your benefits will be i cluded in your HM And if you have many chronic illness having all your care coordinated throug single plan might make sense.

That approach has big drawbac You'll be able to use only the doctors hospitals in your plan's network. If y go to another doc, you'll pay much mo "In some markets, the HMOs offer rich benefits," says Robert Hayes, preside of the Medicare Rights Center, a Ne York consumer group. But, he ad "people will sacrifice the choice of phy cians and hospitals."

In addition, the plan can refuse to p for some costly treatments, such as e perimental therapies. If you get very i your insurer may be increasingly relu tant to cover your care. And as budg deficits explode, don't be surprised those generous federal payments no subsidizing the plans dry up. If they d premiums will rise, benefits will shrin and insurers will abandon the marke just as they did in prior Medicare mar aged care experiments.

If you don't like your plan, you ca switch to another one after a year. If yo decide to return to traditional Medicar however, you may be unable to purchas a supplemental Medigap policy. That because insurers in many states ca deny coverage for illnesses you alread have. A Medigap insurer can exemp your heart disease from the policy o charge higher rates.

For many, the changes in Medicare ar an opportunity to insure against the hig cost of drugs, an increasingly importan element of medical care. For some sen iors, managed care can be an importan low-cost option. Before they choose however, elders and their families are go ing to have to navigate a painfully com plex maze of choices. ■

Medicare Resources

AARP
aarp.org

FEDERAL GOVERNMENT
www.medicare.gov or
1-800-MEDICARE

MEDICARE RIGHTS CENTER
medicareinteractive.org

NATIONAL COUNCIL ON THE AGING
benefitscheckup.org

YOUR STATE
Call your state Senior Health Insurance Information Program (SHIIP)

A Passel of Plans

Starting in November seniors will have several important decisions to make about Medicare. Even if you are already enrolled, you'll have to sort through new options.

STAY IN TRADITIONAL MEDICARE...

- You'll pay your Part B premium ($88.50/month in 2006) but have great flexibility in picking doctors or hospitals.
- You will also have the opportunity to buy a separate drug insurance policy (called Part D). Premiums for Part D will average about $32/month to start but will vary, depending on where you live and what plan you choose.
- You'll have to pick carefully, because some plans will cover the drugs you take, while others may not.
- You will also have to decide whether to buy a Medicare Supplemental insurance policy, called Medigap, which covers hospital and doctor bills not in basic Medicare.
- Medigap policies vary widely in price, depending on where you live and how much coverage you buy. In, say, Albany, N.Y., premiums range from $115 to $220/month.

JOIN MEDICARE ADVANTAGE, A NEW MEDICARE HMO...

- You'll be able to get all your coverage with one policy. Most Medicare Advantage plans will also include a drug benefit and some of the extras in today's Medigap policies.
- If you have many chronic diseases, a plan can help you manage your care among several specialists
- You'll have to go to the doctors or hospitals in the plan and buy only the drugs they approve or else pay a lot more out of your own pocket.
- The plan may also limit or deny coverage for some care.
- As with Medigap, premiums will vary widely.
- If you become ill or dissatisfied with the HMO, you can return to traditional Medicare. But if you do so when you're already sick, the Medigap premiums will be high.

Passing On Your Home–Painlessly

Qualified Personal Residence Trust may spare your ds gift taxes. **BY TODDI GUTNER**

FOUR YEARS AFTER MORT Comer, then 65, bought a $320,000 summer home on the New Jersey shore, he made a wise bet. Figuring he would live at least another decade, he put the house trust that would transfer ownership his two daughters after seven years. en the trust expired in 2004, it passed of his estate and to his children free of taxes—even though it's now worth 5 million.

Comer bought before the latest real es- boom, so his family made out big. if you think the market still has steam you want to pass your house to your dren without huge tax consequences, sider setting up a Qualified Personal idence Trust (QPRT).

With such an arrangement, a parent continue to live in the home for the gth of the trust, usually set at 5 to 15 rs. During that time, the parent is still sidered the owner and can deduct rtgage interest, real estate taxes, and er qualified expenses from personal ome tax. At the end of the term, the se passes to the children and out of parent's estate, regardless of its value accumulated appreciation. The par- may stay on in the house when the t dissolves but must pay fair market to his or her children. The one big eat: If the parent dies before the trust s, the property goes back into the es- and is priced at the fair market value.

ECIAL INTEREST RATE

NCHE LARK CHRISTERSON, a man- g director at Deutsche Bank Private lth Management in New York, ran e numbers to show how a QPRT ks. Say you're 60, and you have a $1.5 ion property on the Massachusetts island of Martha's Vineyard that you want to remain in the family. You can't shelter the entire $1.5 million value because you are retaining the right to use the home. So the trust uses a discounted value instead.

The discount is computed based on a formula that takes into account your age, the trust's term, and a special interest rate that fluctuates with market rates, called the "hurdle rate," which the Internal Revenue Services resets monthly. For September the hurdle rate is 5.04%. Interestingly enough, a QPRT may be one of the few real estate deals that benefit from higher interest rates, says Mitchell Gaswirth, a tax expert with the Los Angeles law firm of Proskauer Rose. "The higher the interest rate, the smaller the corresponding gift."

Based on those factors, Christerson divided the property's $1.5 million worth into two parts: $783,000, known as the remainder interest, the value of the gift the kids are expected to receive at the end of the trust term, and $717,000, known as retained interest, which represents the value of the right to live in the house. The older you are or the higher the hurdle rate, the bigger the retained interest—and the smaller the gift—for gift tax purposes. Remember, you have a $1 million lifetime gift-tax exclusion ($2 million per couple), and you'll use $783,000 of it by putting the house in the trust.

THE NEW LANDLORD

ASSUME THAT 10 years later, the house is worth $2.5 million. Your kids now own it, and there is no additional gift tax, even though they are receiving a more valuable property. Giving the kids the house outright or leaving it to them as part of your estate would result in far higher tax bills.

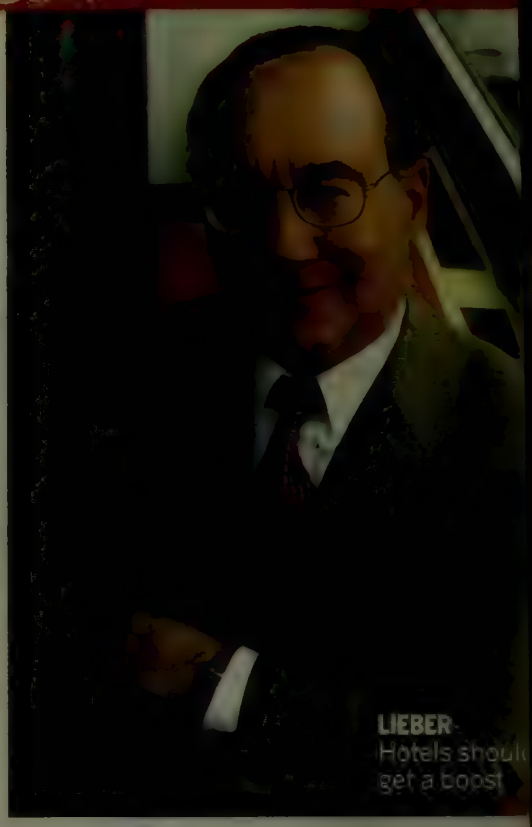
If your children decide to sell the house, they must use your cost basis. So if you paid $100,000 for the house years ago and made $200,000 worth of improvements to it, the basis is $300,000. Sell it for $2.5 million, and your children would have capital gains of $2.2 million. Still, the capital gains tax rate is lower than estate or gift tax.

While the appeal of transferring one of your most valuable assets to children may be high, estate planning experts warn of the family friction that can result when children are their parents' landlords. To avoid that situation, it may be smarter to transfer the house to another trust with trustees of your choice after the QPRT expires. That way, the kids own the house, but the trustees make the decisions.

Mort Comer has had no such problem with his daughters, Caren Comer, 43, and Joya Comer Friedman, 39. He pays them $10,000 a year in rent, and he still uses the house when they and their families visit. For the Comers, the trust helped to keep the house in the family and ensure that everyone can enjoy it together. ■

Shelter After The Storm

This real estate ace sees lots of opportunities —and no bubble



LIEBER Hotels should get a boost

SAMUEL LIEBER HAS A MUCH ROSIER VIEW of the real estate market than headlines of hurricanes, housing bubble, rising interest rates, and soaring energy prices would have you expect. Lieber manages Alpine U.S. Real Estate Equity Fund, which has delivered an annualized return of over 20% during the past decade through its ownership of real estate-related companies and investment trusts (REITs). Personal Business Editor Lauren Young spoke to Lieber about investment opportunities in the sector.

Who will benefit most from the post-Katrina rebuilding effort?

The first beneficiaries are recreational-vehicle makers. When hurricanes hit Florida last year, the Federal Emergency Management Agency put 15,000 RVs in the region to give people shelter. Now the agency is talking about many, many more. Thor Industries and Fleetwood Enterprises are two of the companies that are building RVs at lower price points.

The manufactured-home industry can really crank out homes, too. Some of the biggest players, including Champion Enterprises, have restructured, shut factories, and paid down debt. Now, with rising demand, companies may have better pricing power. We have positions in Champion, Fleetwood (which also makes manufactured homes), and the more upscale Palm Harbor Homes. All of them have posted double-digit gains since the hurricane.

What about major homebuilders?

Our top holdings are the national chains, including Toll Brothers, Pulte Homes, and KB Home. Assuming we don't have a recession, they can provide earnings growth of 15% to 20% over the next couple of years. They have large backlogs, strong balance sheets, and an ability to increase market share at a double-digit pace.

> "[Homebuilders] can provide earnings growth of 15% to 20% over the next couple of years"

Will they get a big pop from the hurricane business?

Right now they don't have much exposure to the Gulf States. However, Lennar, KB Home, D.R. Horton, and Pulte all have major operations nearby—mostly in Texas—which means they can set up shop in the Gulf pretty quickly. It makes sense to bring in three or four of these big builders that have the expertise and capacity to build thousands—perhaps as many as 80,000—homes.

Nearly a third of your fund is in lodging stocks. What's your outlook there?

Two of our holdings are Hilton Hotels and Starwood Hotels & Resorts, which own and operate upscale hotels in densely populated markets. Business travel shouldn't be hurt much by higher energy costs, so these two chains should see big room-rate gains over the next few years. Incidentally, while most of the hotel chains in New Orleans are national, they have only about 2% to 5% exposure terms of revenue loss. That has been m than offset by the exodus in the regio hotels are booked everywhere.

What's your take on the housing marke

I'm not worried about a housing bubl About 70% of American households o homes, and the Federal Reserve doe want to put the kibosh on that.

For most mortgage holders, higher terest rates should be manageable. Ra on 10-year bonds could go to 6.5% over next two or three years. That may t steam out of the economy, but that's O.I do worry about short-term hybrid mo gages, though. With so many issued, th will be sticker shock for some consum in three to four years. Last year we hi record for subprime loans—issuan reached $530 billion.

What about multifamily housing?

Some apartment REITs are seeing a sho term lift from Katrina, with occupan rates in the Gulf rising by 4%. United I minion Realty Trust is the biggest in t area. Camden Property Trust has ma properties in Texas, and other players clude Equity Residential and Aimco. Th higher occupancies sho last only 6 to 12 mont Apartment REITs will co tinue to be limited by bo cheap mortgages for sing family housing and mod income growth. I think th stocks are overpriced. ■

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OLD SCHOOL Schine wows sons Nicholas and Charlie with his shuffleboard skill

The Call of the Queen Mary

A week of ease—and the kids didn't miss video games a bit. BY ERIC SCHINE

WHEN I WAS FIVE, my parents took my sister, then eight, and me on a trip to France. It was 1961, and since my mother didn't like flying my parents decided to take a ship. We left New York one hazy afternoon in June on the small—though it seemed plenty big to me—French ship Le Flandre. Eight days later we landed in Le Havre.

Those eight days were a revelation. As a typical suburban Connecticut kid, I rarely ventured more than a two-square-mile radius from my house. My preferred cuisine: Frosted Flakes for breakfast and baloney sandwiches for lunch. Now I was on the open sea, bound for lands unknown. I'd dine on fresh croissants and prosciutto and melon for breakfast, veal scaloppini and *petits pois* for lunch. At night in the children's dining room, I'd dress up in a jacket and tie and eat the same fabulous meals as the grownups.

When we weren't *à table*, there wasn't a whole lot to do. I hardly remember seeing our parents on the crossing, especially in the evening, when they stayed out late dancing or taking a turn at the roulette wheel. So we whiled away the hours playing shuffleboard or running around the ship to hide from our babysitter, Mrs. Brown, whom our parents insisted on bringing along.

It was a long time ago, but I have never forgotten that trip. Last winter, as my son Nicholas approached his fifth birthday, I became fixated on taking my family on a transatlantic crossing. My wife, Julie, worried that the trip would be too expensive and too upscale for our tastes. She had a point: The glossy brochure for the Queen Mary 2, the only ship that still makes regular transatlantic crossings, features photos of silver-haired men in tuxedos and elegant women in evening gowns and jewels—a different crowd than the folks we met on last summer's car-camping trip. But there was no deterring me. I wanted to know: Would the crossing hold the same thrill for Nicholas and Charlie, age 8, as it did for me?

In April we booked passage through our American Automobile Assn. travel agent for an early August sailing on the QM2. We reserved adjoining outside cabins, with balconies, that listed for about $3,150 per person, including return airfare, though our travel agent got us about a 20% discount. A favorite family pastime last spring was logging on to cunard.com for a virtual tour. Charlie marveled that the ship, four football fields in length and with 14 decks, "is almost as long as the Empire State Building is tall." The boys checked out the five swimming pools, four formal restaurants, Canyon Ranch Spa, 1,100-seat theater, and much more. We also decided we had to look the part. So off we went to the boys' department of Brooks Brothers for blue blazers, white khakis, and colorful ties. Julie and I upgraded our threads as well for the three formal dinners we'd be attending.

QM2's Vital Stats

When the big day came, we pulled up he New York City Passenger Ship Ternal, where West 54th Street meets the dson River. There she was: immense, king, towering, all black and white l gleaming. As passengers and porters tled about, big cranes hoisted huge lets of supplies. Although my mom l stepdad stopped by to bid us good-, the scene was nothing like my mem-, when my grandparents, aunts, un-, and cousins all crammed into our in to don paper hats and raise a glass. se days, for security reasons, visitors not allowed onboard.

s the QM2 blasted its thundering istle and started to edge away, Julie l I stretched out on deck chairs and ed gin and tonics while the boys had zer with lime. The breeze picked up as watched the Manhattan skyline slip t. By the time the ship was under the razano Narrows Bridge, the four of us e seated in the Britannia Grill, a two-y dining room with a grand entrance n a pair of curving stairways.

xhausted from the day's excitement, made our way back to our adjoining ins. Nicely designed, they were both pact and roomy-feeling, with plenty loset space, a king-size bed for us, and beds for the boys. Each cabin also a desk, a couch, a small balcony, and athroom. As the boys wrote in their rnals, Julie and I cozied up with the t day's programs. I had planned to get t of reading done and wasn't much insted in the tango lessons, history lecs, computer classes, cooking courses, planetarium shows. But there was ty for the others to do.

RIETY GALORE

E NEXT MORNING, while Julie headed o the spa, the boys and I trekked aft to t quickly became our favorite pool. nked by two hot tubs and a fabulous w of the churning wake, it was surnded by a spacious sundeck with a By lunchtime Charlie had a new nd named Blake.

n the afternoon we signed the boys into Play Zone, where dozens of kids were ing a wild game of Nerf ball. Here kids y supervised play from morning until night, with the exception of two short breaks at mealtimes. The staff was great, organizing a treasure hunt and dreaming up all sorts of games with energy and enthusiasm. They needed both: Of the 2,600 passengers, about 350 were children.

Back at our room an envelope was waiting for us: Please join Blake and his family for a cocktail party in the Windsor Suite at 7:30. We were greeted at the door by Blake's gregarious father, a New York banker, the father's companion, Blake's courtly grandfather, his nanny, his French tutor, and assorted QM2 staff, who handed us champagne and hors d'oeuvres.

As guests discussed the good old days when ships were more intimate, I slipped away to inspect the Windsor Suite. It's a grand palace, with a foyer, kitchen, living room, and dining area, and a roomy teak-

SUITED UP Nicholas, 5, and Charlie, 8, on the bridge

decked patio. A sweeping spiral staircase leads up to a bedroom with an ornate bathroom. According to the QM2 brochure, it goes for a mere $30,869 per person for the six-day crossing.

Plenty of people of more modest means were around, too. At night the theater was filled with retirees and families watching the fun, if sometimes hokey, mix of nightclub acts, comics, and Las Vegas-style revues. After the show many folks filed into the Queens Room, with its immense dance floor and orchestra.

But for us the best entertainment was the dining. We took most of our meals in the Brittania Grill. It serves breakfast and lunch and has two dinner seatings. On our first night Julie and I ordered salads and grilled salmon, while Charlie tried roasted strip loin and Nicholas went with spaghetti bolognese from the children's menu. For dessert Julie had Grand Marnier crème brûlée, while I chose apple strudel with brandy sauce. The boys happily dug into white chocolate-and-raspberry parfaits.

A MEMORABLE FEAST

AFTER A FEW DAYS of such excess, Julie and I started ordering from the Canyon Ranch Spa Menu—lighter fare, with smaller portions. We saved our best meal for last: a sumptuous feast of lobster risotto for Julie and lamb for me at the intimate Todd English restaurant for a supplement of $30 per person.

Before we knew it, our six days were nearly over. The weather was turning chilly as we entered the English Channel. Charlie and Nicholas spotted a few birds, then a small fishing boat, and finally the southern coast of England. On our last afternoon, a glorious and breezy day, we found the remote deck where little-used shuffleboard courts await nostalgia buffs like me.

As we played our game, I thought about the ways a transatlantic crossing in 2005 has changed since my 1961 trip. Back then ships were a mode of transportation with some entertainment thrown in. Now a crossing is, in some ways, like any other cruise: a nonstop party. Yet aspects of the trip are no different than my youthful journey. It's still possible to dream away the hours contemplating the deep azure of the mid-Atlantic and gazing at the brilliant display of stars at night.

When our week-long vacation in France ended, we retraced in an eight-hour flight the route we had taken over water. Midway through, Nicholas looked down at the ocean below and said: "Planes are so boring. There we were on the waves. That was the best vacation of my whole life." At that moment I knew I had accomplished my mission. ■

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WEB SITE cunard.com

EDITED BY TODDI GUTNER

TIME OFF

CALLING ALL RAILROAD BUFFS —TO SCRANTON

ENJOY FALL FOLIAGE on a Pullman car, a caboose, and other vintage rolling stock at the **Steamtown National Historic Site** in Scranton, Pa. Two hours by car from both New York and Philadelphia, Steamtown boasts a collection of steam locomotives and cars dating back to the 1890s (www.nps.gov/stea/home.htm). To make reservations for the October excursions, call 888 693-9391, ext. 5204 between 9:30 a.m. and 4:30 p.m daily. Other area attractions for railroad buffs: the Radisson Hotel Scranton, a former Lackawanna Railroad station on the U.S. National Register of Historic Places, and Grzyboski's Train Store, which claims to be Pennsylvania's largest Lionel train dealer. *–Monica Gagnier*

MUTUAL FUNDS

Lower-Class Shares

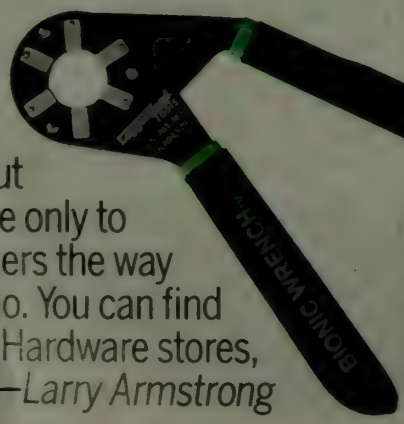
FUND COMPANIES WITH up-front loads battled the no-loads in the 1990s by introducing share classes that eliminated the sales fees by burying them in higher annual charges. The tactic worked better for the companies than for shareholders, according to a study by professors Vikram Nanda and Lu Zheng at the **University of Michigan** and Z. Jay Wang at the **University of Illinois.**

They compared the performance of diversified U.S. equity funds that had only one share class between 1993 and 2002 with those that added B or C class shares. Not surprisingly, they found that new classes helped bring in more money faster—about 12% on average for the year following the change—making funds more profitable for managers. They also learned that the new classes attracted lots of short-term traders.

Both the influx of money and the presence of short-term traders dragged down the funds' performance by 1.2% to 1.7% a year relative to one-class funds, even after adjusting for expenses and other factors. The results should serve as a warning to investors when a fund issues B or C shares, says Zheng. *–Aaron Pressman*

GADGETS

FUNNY HOW WHENEVER you need a wrench, the exact size you require is nowhere to be found. The Bionic Wrench is a hybrid between a wrench and a pair of pliers that automatically adjusts itself to fit any bolt or nut from 7/16- to 3/4-inch, or any of 10 different metric sizes. As you squeeze the handles together, six hardened-steel pins move in like pistons to grasp the nut or bolt securely. Because it applies force only to the side surfaces, it won't strip the corners the way conventional wrenches or pliers often do. You can find it for about $30 in tool catalogs, at Ace Hardware stores, or at loggerheadtools.com. *—Larry Armstrong*



EDUCATION

COLLEGE FUNDS: A SAFE HARBOR

THE TOUGH NEW bankruptcy abuse prevention law that goes into effect in October has a silver lining for families who have set aside funds for higher education. It will shield any money in state-sponsored **529 college savings accounts** as long as you contributed it more than two years before declaring bankruptcy. A few states already had some protection in place, but the federal law overrides any states in which 529 assets are fair game for creditors. *–Anne Tergesen*

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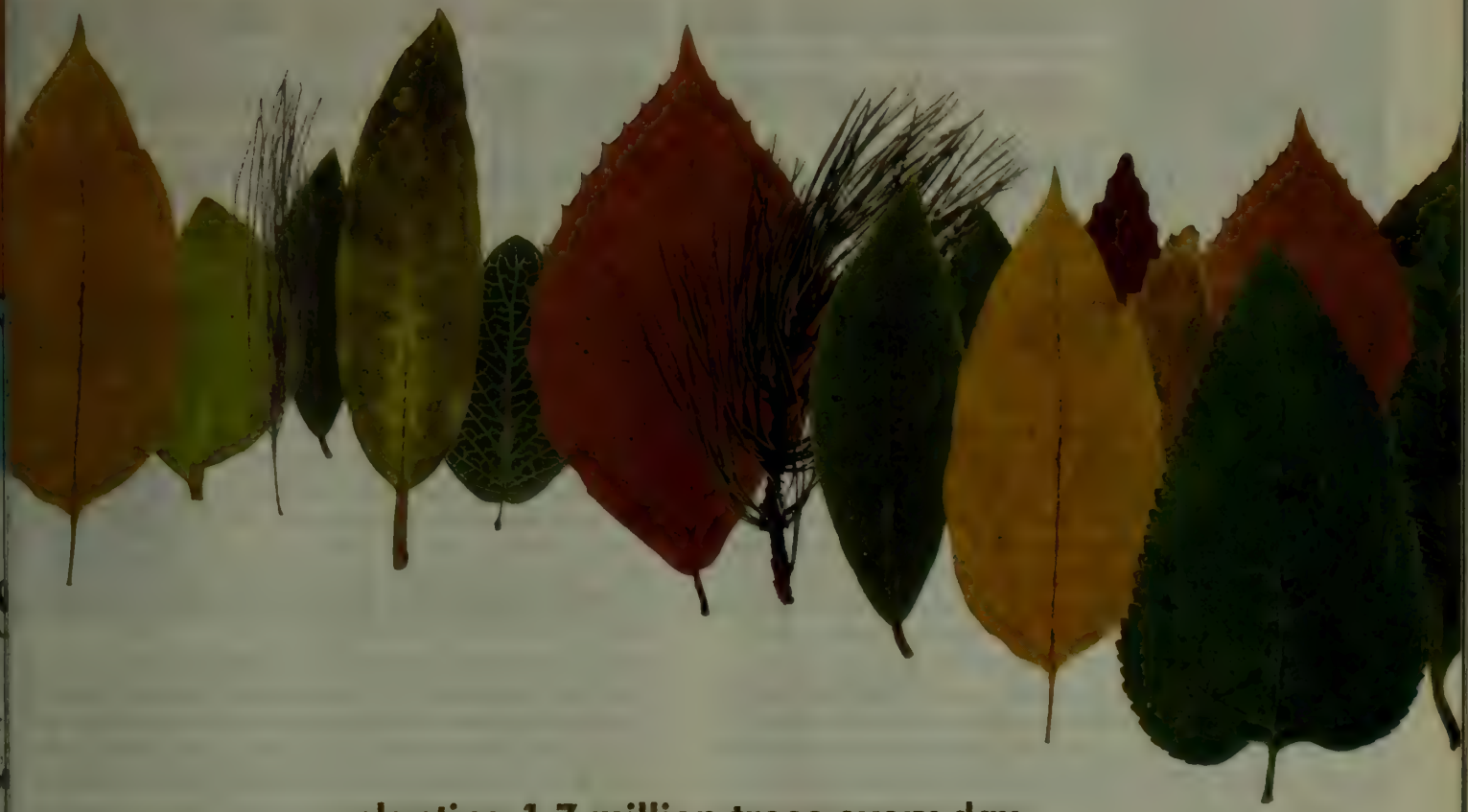

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BY GENE G. MARCIAL

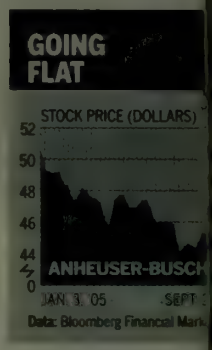
FOREIGN BEER MAY HELP QUENCH ANHEUSER'S THIRST TO GROW

SYMMETRY'S ARTIFICIAL HIPS AND KNEES ARE IN HOT DEMAND.

A POST-KATRINA CONSTRUCTION BOOM MAY BOOST HEADWATER

Bud Taps New Markets

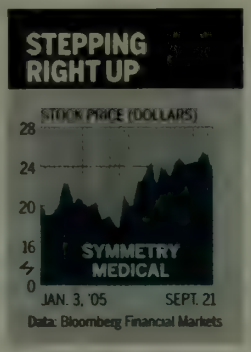
ANHEUSER-BUSCH (BUD), maker of the King of Beers, doesn't get much respect on the Street. Major analysts are down on the stock, which has slid from 50 in early January to 44 now. Although it controls 50% of the U.S. beer market, Anheuser has shown little growth in recent years for two reasons, note the bears: Beer sales have been flat—unlike those of wines and spirits. And its market share hasn't expanded because its main brands cater to low-income groups. Looking beyond Anheuser's current malaise, however, are some smart-money pros, including Warren Buffett, whose Berkshire Hathaway bought a sizable stake in Anheuser in April. (A Berkshire spokeswoman did not return calls for comment.) Sarat Sethi, a principal at investment firm Douglas C. Lane & Associates, which has accumulated shares, says Anheuser's woes will be short-lived. The company has taken steps to cope with market pressures, including stiff competition from Miller and Coors. Anheuser is twice the size of Miller and four times as big as Coors. Sethi says its premium new "Bud Select" should attract high-end drinkers and add oomph to earnings. The next big growth driver will be foreign markets, such as China and Mexico, he says. Anheuser owns 27% of China's Tsingtao Brewery and 50% of Mexico's Corona. Steve Rogé of Rogé Partners Fund, which owns shares, says Anheuser is a long-term play that will reward patient investors. He predicts that by 2006's second half, Anheuser will see double-digit earnings growth. It has a 2.4% dividend yield and has been buying back shares. Rogé sees profits of $2.65 a share in 20[illegible] and $2.85 in 2006. He puts Anheuser's intrinsic worth at 5[illegible]



An investor should consider investment objectives, risks, charges and expenses of the investment company carefully before in[illegible] prospectus carefully before investing. *Usual brokerage commission applies. Since inception in 1993, the SPDR Trust has distributed [illegible] American Stock Exchange LLC. SPDRs are not sponsored, endorsed, sold or promoted by Standard & Poor's and S&P makes no representation rega[illegible] ALPS Distributors, Inc., a registered broker-dealer, is distributor for the SPDR Trust, a unit investment trust.

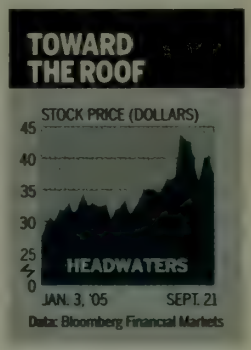
iant Strides at Symmetry

YMMETRY MEDICAL (SMA) is sitting pretty in the fast-growing orthopedics market: It designs and makes implants used in joint replacements—mainly hips and es—including the instruments to them in place. Big manufacturers h as Zimmer and Stryker are sourcing more and more of what need, says Craig Leighton of estment firm Lord Abbett, which s shares. Symmetry is the largest plier to those big makers. Its rating margin of some 20%, says ghton, is aided by its low-cost rations. And the steady rise in ers fueled by an aging population delivered solid earnings, he adds. odore Huber of Wachovia Securities expects Symmetry will n 96¢ a share in 2005, $1.20 in 2006, and $1.41 in 2007, up n 2004's 44¢. Now at 23 a share, the stock should hit 31 in 6 2 months, figures Huber, who rates it "outperform."



uilding Back with Headwaters

HEADWATERS (HW) used to be only an energy play, but lately its construction-materials business has been catching the eye of investors. Zacks Investment earch, for one, tags Headwaters a buy in good part use of the expected leap in demand for construction erials to cope with the havoc wrought by Hurricane Katrina. Mario Ricchio of Zacks sees Headwaters as a "niche producer" of two key materials: fly ash and manufactured stones. The proportion of fly ash as a binding material in concrete has been rising, he notes, because it increases its structural strength. Headwaters' fundamentals are "extremely positive," says Ricchio. He forecasts earnings of $2.23 a share in the year ending Sept. 30 on revenues of $1.05 billion (boosted by acquisitions), rising to $2.67 in fiscal 2006 on revenues of $1.16 billion. That's up from $1.69 in 2004 on $554 million. Another bull on Headwaters is Richard Steinberg, president of Steinberg Global Asset Management, which owns shares. He sees it as a little-known and undervalued play. In addition to building materials, Headwaters is also in the business of converting coal and heavy oil into liquid fuels that are used by power generation plants to comply with environmental standards. The energy business accounts for 35% of total revenues, while construction materials are expected to bring in about 50% this year. Industrial services provide the remainder. Its stock—after rising sharply from 26 in January to 45 in July—has eased to 36. But Steinberg sees it regaining its upward momentum soon. His 12-month price target: 48.



BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

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ds (ETFs) have become one of the world's fastest growing investments. It all started with Spiders (SPY), the first of the species. ighest market value among the more than 140 ETFs that exist today. Each Spider puts the strength of the entire S&P 500 to work in a's leading companies in every share. Spiders are tax-efficient and have low management fees.* Like stocks, they can be urse, Spiders are subject to similar risks. This granddaddy's been around, but can still add some muscle to any portfolio. **mbol Amex:SPY. The entire S&P 500 in every share.**

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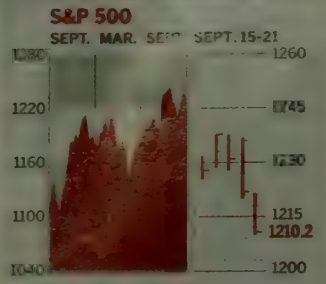


COMMENTARY

With many Americans glued to the TV tracking the path of the latest hurricane, the Fed created a tempest of its own on Wall Street when it nudged its key rate up a quarter point. While not unexpected, the move unnerved traders who'd hoped Greenspan & Co. might signal an end to the hike cycle. Stock indexes all fell for the week, but, surprisingly, the 10-year T-note price rose.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	SEPT. 21	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1210.2	-1.4	-0.1	7.2
Dow Jones Industrials	10,378.0	-1.6	-3.8	1.3
NASDAQ Composite	2105.6	-2.0	-3.2	9.7
S&P MidCap 400	696.4	-2.3	5.0	17.2
S&P SmallCap 600	340.6	-2.1	3.6	16.2
DJ Wilshire 5000	12,070.4	-1.6	1.0	9.5
SECTORS				
BusinessWeek 50*	744.3	0.4	5.6	13.3
BW Info Tech 100**	363.2	-1.3	-2.7	9.0
S&P/BARRA Growth	575.6	-1.3	-0.6	5.6
S&P/BARRA Value	627.5	-1.5	0.3	8.6
S&P Energy	406.9	4.0	41.0	46.6
S&P Financials	391.1	-1.5	-4.9	-0.3
S&P REIT	149.4	-3.4	3.4	17.6
S&P Transportation	215.2	1.9	-10.9	2.8
S&P Utilities	156.7	-0.6	17.8	30.4
GSTI Internet	171.7	-2.1	-3.7	15.5
PSE Technology	800.7	-2.4	2.8	15.9

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	SEPT. 21	WEEK	% CHANGE YEAR TO DATE
S&P Euro Plus (U.S. Dollar)	1438.5	-0.8	3.0
London (FT-SE 100)	5369.7	0.4	11.5
Paris (CAC 40)	4468.1	-0.1	16.9
Frankfurt (DAX)	4875.2	-0.7	14.5
Tokyo (NIKKEI 225)	13,196.6	2.8	14.9
Hong Kong (Hang Seng)	15,223.6	0.9	7.0
Toronto (S&P/TSX Composite)	10,957.1	0.2	18.5
Mexico City (IPC)	15,734.4	3.4	21.8

FUNDAMENTALS	SEPT. 20	WEEK AGO	YE
S&P 500 Dividend Yield	2.04%	2.03%	1.
S&P 500 P/E Ratio (Trailing 12 mos.)	19.1	19.3	2
S&P 500 P/E Ratio (Next 12 mos.)*	15.0	15.2	1
First Call Earnings Revision*	1.28%	0.57%	-0.

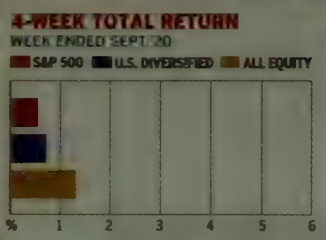
*First Ca

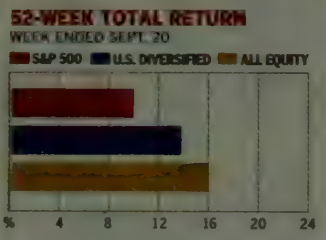
TECHNICAL INDICATORS	SEPT. 20	WEEK AGO	RE
S&P 500 200-day average	1198.8	1187.7	Pos
Stocks above 200-day average	59.0%	65.0%	Ne
Options: Put/call ratio	0.73	0.69	Pos
Insiders: Vickers NYSE Sell/buy ratio	5.24	5.03	Neg

BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Oil & Gas Refining	27.6	Oil & Gas Refining	128.1
Oil & Gas Exploration	16.2	Oil & Gas Exploration	77.0
Gold Mining	14.7	Fertilizers & Ag. Chems.	68.4
Divsfd. Metals & Mining	11.4	Oil & Gas Drilling	67.3
Oil & Gas Storage	10.3	Managed Health Care	61.9

WORST-PERFORMING GROUPS	LAST MONTH %		LA MON
Home Furnishings	-19.7	IT Consulting	-
Specialized Cnsmr. Serv.	-14.2	Automobiles	-
Educational Services	-13.7	Home Furnishings	-
Computer Retailers	-12.4	Insurance Brokers	
Home Frnshngs. Retailers	-11.0	Photographic Products	-

MUTUAL FUNDS





Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Latin America	12.4	Latin America	70.7
Precious Metals	11.3	Natural Resources	52.3
Natural Resources	9.2	Diversified Emerg. Mkts.	40.6
Diversified Emerg. Mkts.	6.2	Utilities	32.9
LAGGARDS		**LAGGARDS**	
Miscellaneous	-0.3	Financial	7.8
Financial	-0.1	Domestic Hybrid	8.5
Communications	0.5	Large-cap Blend	10.2
Mid-cap Blend	0.5	Large-cap Growth	10.6

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
ProFunds Precs. Mtls. Inv.	18.6	Guinness Atkn. Gl. Energy	87.4
iShares MSCI Brazil Idx.	17.7	U.S. Glbl. Invs. Gl. Rscs.	79.3
Midas	15.7	BlackRock Gl. Res. Inv. A	78.9
Fidelity Select Gold	15.0	T. Rowe Price Lat. Am.	77.8
LAGGARDS		**LAGGARDS**	
Rydex Retailing Inv	-6.6	Ameritor Investment	-56.0
ProFunds Cnsmr. Svcs. Inv.	-6.5	ProFds. USh. Mid Cap Inv.	-29.9
Turnaround	-6.4	ProFds. USh. Sm. Cap Inv.	-26.8
Fidelity Select Retailing	-5.7	Potomac Sm. Cap/Sh. Inv.	-19.5

INTEREST RATES

KEY RATES	SEPT. 21	WEEK AGO	YEA
Money Market Funds	3.15%	3.09%	1.
90-Day Treasury Bills	3.39	3.43	1.
2-Year Treasury Notes	3.92	3.88	2.
10-Year Treasury Notes	4.17	4.17	4.
30-Year Treasury Bonds	4.46	4.45	4.
30-Year Fixed Mortgage †	5.72	5.66	5.

†BanxQuote.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BON
General Obligations	3.67%	4.4
Taxable Equivalent	5.24	6.3
Insured Revenue Bonds	3.86	4.6
Taxable Equivalent	5.51	6.5

THE WEEK AHEAD

EXISTING HOME SALES *Monday, Sept. 26, 10 a.m. EDT* » August home resales are expected to have edged down to an annual rate of 7.1 million, after cooling off in July. That's the consensus forecast of economists polled by Action Economics.

CONSUMER CONFIDENCE *Tuesday, Sept. 27, 10 a.m. EDT* » The Conference Board's September consumer confidence index probably eased to 99.5, after climbing to 105.6 in August. There may be some downside risk to the forecast given the large tumble in the University of Michigan's preliminary September consumer-sentiment index.

NEW HOME SALES *Tuesday, Sept. 27, 10 a.m. EDT* » New home sales most likely eased to an annual rate of 1.3 million in August, after rising to 1.4 million in July.

DURABLE GOODS ORDERS *Wednesday, Sept. 28, 8:30 a.m. EDT* » Orders for durable goods probably picked up by 0.5% in August, after July orders tumbled 4.9%.

PERSONAL INCOME *Friday, Sept. 30, 8:30 a.m. EDT* » Personal income is forecast to have risen 0.4% in August, after a 0.3% increase in July. Consumer expenditures probably contracted 0.2% because of slower August auto sales. In July, sales rose 1% for a second straight month.

The *BusinessWeek* production ind rose to 254.5 for the week end Sept. 10 and stood 11.7% above t year-ago level. Before calculation the four-week moving average, t index climbed to 254.9.

BusinessWeek onlin

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/extra

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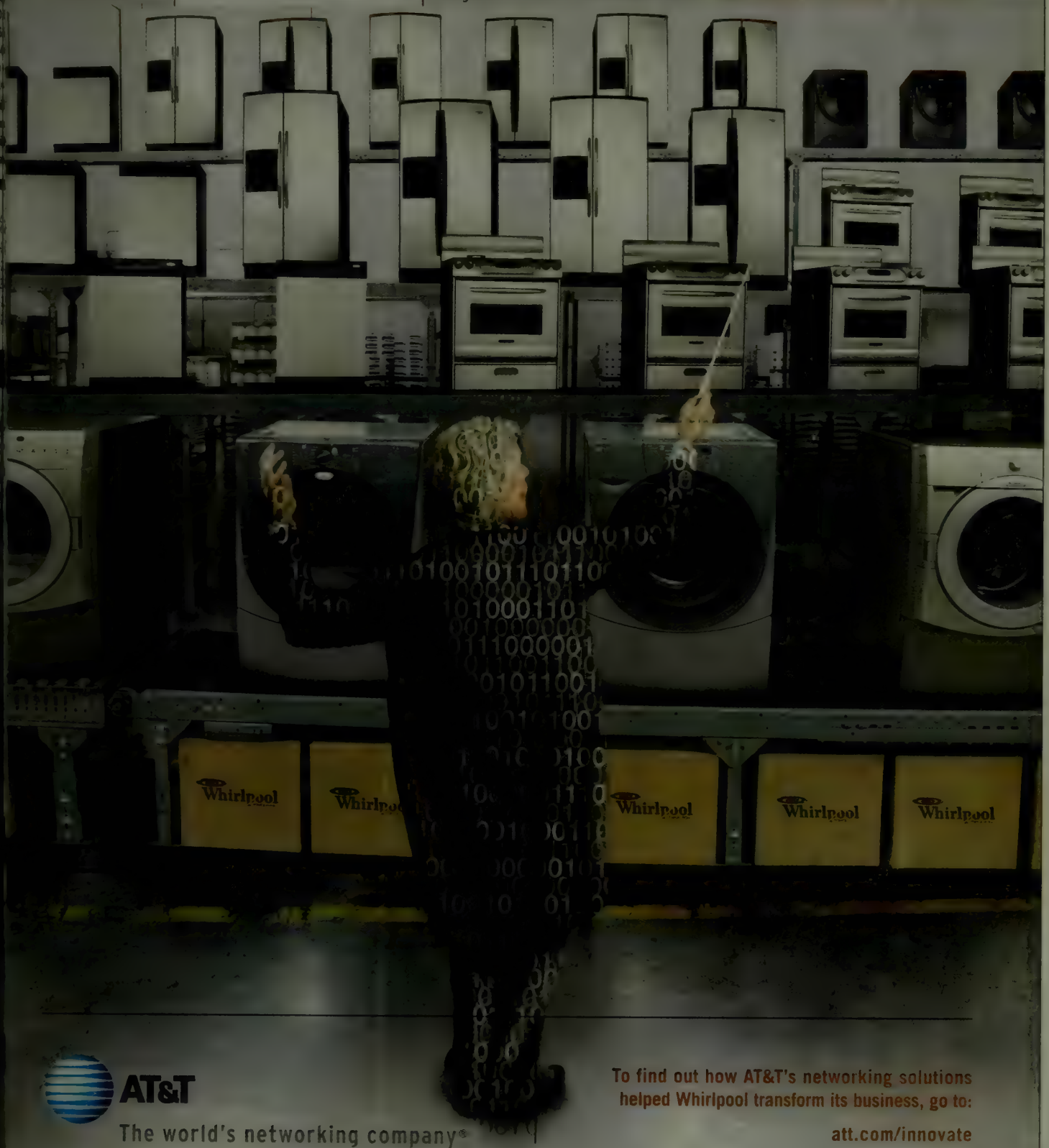

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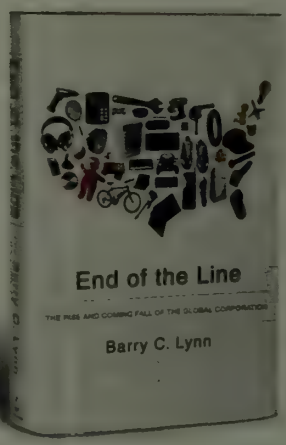
IdeasBooks

Too Lean a Machine?

END OF THE LINE The Rise and Coming Fall of the Global Corporation
By Barry C. Lynn; Doubleday; 312pp; $26

Big American companies have been enormous generators of shareholder wealth over the past three decades, dominating markets, gobbling up competitors, ruthlessly slashing costs—and workers—to stay ahead in the game of globalization. But that may be about to change, says Barry C. Lynn in *End of the Line: The Rise and Coming Fall of the Global Corporation*. These same outfits "have built a system so hyperspecialized and so lean that a relatively small glitch in production on the far side of the world has the potential to devastate large swaths of the American economy," he contends. That system, which involves just-in-time inventory controls, outsourcing of production, and deregulation by Washington, "may prove to be perhaps the single most grave error in the history of the American nation," Lynn says.



This is pretty harsh. But some disturbing evidence of our vulnerability has already appeared in the headlines. As Lynn points out, a 1999 earthquake in Taiwan shut down electronics factories around the world by interrupting supplies of semiconductors manufactured by just two companies in the same industrial park. One explosion at a chemical plant in Japan in 1993 cut off half the world's capacity for a resin used to make computer chips. The next month, the price of memory chips doubled, driving laptop prices up by $100. A 10-day West Coast longshoremen's strike in 2002 cost the U.S. economy $20 billion in lost production when American factories were unable to import components. And the September 11 terrorists succeeded in shutting down air traffic for days and slowing the movement of goods from Mexico and Canada.

Using the examples of U.S. multinationals such as Cisco Systems, Dell, FedEx, General Electric, General Motors, and Wal-Mart Stores, Lynn shows how cost-cutting and outsourcing by industry leaders have fed on themselves, leaving corporations dangerously open to even minor supply-chain interruptions. How has this happened? FedEx has encouraged U.S. manufacturers to depend on daily delivery of global components to their assembly lines. Cisco has shown how a high-tech manufacturing behemoth can be created by assigning in advance most of the work to other companies, leaving little in-house.

> **Years of offshoring have left business highly vulnerable**

Lynn doesn't fault corporate managers as much as post-World War II federal economic policy, especially that of the Clinton Administration. Washington has repeatedly substituted a misguided enthusiasm for globalization and free-trade deals for the pro-manufacturing industrial policy favored by Alexander Hamilton and nearly two centuries of leaders, says Lynn. The U.S. also came to view the scattering of its production facilities around the world as a clever foreign-policy tactic to fight the Cold War, spread democracy, and draw nations together in an interdependent web. Now, America faces "the end of the line," or a precipitous decline in manufacturing capability, thanks to

ades of determined offshoring. Drawing the link between hington's policy-bungling and orate shortsightedness is vocative stuff, and Lynn, a longtime iness journalist, hammers home his sage with apt references to temporary corporate history. But *of the Line* isn't without flaws. We 't get much color or insider detail on thinking of the corporate chieftains so radically transformed the iness landscape.

n Lynn's solutions chapter—*de eur* for such books—he calls for the of radical reregulation of our "industrial commons" that we'll never see from the current White House, Congress, and Supreme Court. For example, he'd like to require companies to triple-source components and services from two or more nations and then to make all these contracts public.

This won't happen anytime soon. Nor, in my opinion, are we about to see the fall of the global corporation, as he sketches it out. But when Hollywood remakes this book into a movie—"Earthquakes! Terrorism! Supply chain disruptions!"—antiglobalists will probably flock to the theaters. ■

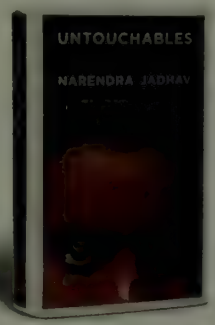
–By Paul Magnusson

Brief

p From Caste

OUCHABLES
Family's Triumphant Journey Out of Caste System in Modern India
arendra Jadhav; Scribner; 295pp; $26

ne of every six of India's illion people is born an uchable, a member of the st stratum in Hindu ety. In rural parts of the ntry, untouchables—also d Dalits—are still idden to draw water from same wells as their upper- e neighbors. Even in the s, Dalits are subject to le discrimination. But their lives improved over the past century as a lt of a struggle for equal rights. One ess story is that of the chief nomist for the Reserve Bank of India, endra Jadhav. *Untouchables: My ily's Triumphant Journey Out of the e System in Modern India* is his uctive memoir.



dhav's chronicle first took form in ate 1960s, when his newly retired practically illiterate father, Damu, n to record his memories. After nu's death, Jadhav combined the llections with those of his mother other family members. The ting account was first published in 3 in the Marathi language spoken in around Bombay, and in an English on in 2003. Both volumes were -sellers in India, and the book has now been published in the U.S.

The account tells how, starting in the 1920s, Damu became a foot soldier in the civil rights movement led by Bhim Rao Ambedkar, the university-educated Dalit leader during India's battle for independence. In his first act of rebellion, Damu joined other Dalits to march en masse to a water tank where, in a symbolic move intended to establish Dalit human dignity, they took a drink. The act scandalized Brahmins—and prompted an elaborate purification ritual. For Damu, the event was a defining moment: He went on to participate in other actions that led to greater Dalit acceptance and to fight tenaciously to win proper education for his children.

Jadhav lets his daughter, Apoorva, a student at Johns Hopkins University, have the final say. She sums up the distance her family has traveled in just three generations, saying she doesn't reflect much on her caste. "I have no reminders of being a Dalit, or any reason to think I am different from my peers," she says. *Untouchables* is an important chronicle of a battle against oppression and the improved prospects for victory. ■

–By Jessi Hempel

By *BusinessWeek* Writers

Women's Letters: America from the Revolutionary War to the Present, edited by **Lisa Grunwald** and *BusinessWeek* Editor-in-Chief **Stephen J. Adler**, has just been published by Dial Press.

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IdeasViewpoint

BY ROBERT J. BARRO

What Price Catastrophe Risk?

Hurricane Katrina and last December's Indian Ocean tsunami demonstrate the potentially huge social and economic consequences of rare natural disasters. But in the 20th century, the world's largest econom disasters were man-made, rather than natural, occurrences: the Great Depression of the 1930s and World Wars I and II. Although these economic catastrophes occur infrequently, worries about their prospects matter every day for financial markets.

In my research, I define an economic disaster for a single country as a collapse of gross domestic product by at least 15% over a short period. Only 2 of 20 advanced economies with available data (Norway and Switzerland) avoided having at least one such disaster in the 20th century. Although the U.S. fared well economically during World War II, 9 of the 20 had major contractions—declines in real per capita GDP ranged between 45% and 64% for Austria, France, Germany, Greece, Italy, Japan, and the Netherlands. During World War I, eight had contractions of 15% to 35%, and another eight (including the U.S.) had similar shortfalls during the Depression.

AN ALLOWANCE FOR varying probabilities of disaster events may explain a lot of riddles in the study of finance, including the famous "equity premium" puzzle defined in an article by Rajnish Mehra and Edward C. Prescott in the 1985 *Journal of Monetary Economics*. The two noted that the U.S. and other major countries had spreads between the average returns on stocks and short-term government bills of some seven percentage points per year. The size of this spread was hard to explain in standard economic models. But especially perplexing was why real interest rates on relatively safe assets, such as U.S. Treasury bills and high-grade commercial paper, were so low, averaging only 1.5% a year since 1880.

Higher expectations of global conflict keep Treasury rates low

In an article only three years after the Mehra-Prescott paper, University of Iowa economist Thomas Rietz argued that the high equity premium and the low risk-free real interest rate could be explained by fears of low-probability disaster events, such as a depression. People are risk-averse and try to protect themselves against a collapse of stocks in bad economic times. My analysis suggests that the Rietz thesis explains not only the high equity premium and low risk-free rate but also several other conundrums, including the volatility of stock prices.

In my version of Rietz's theory, the average equity premium and risk-free rate can be accounted for if there's something like a 1% annual probability of a global event that cuts output by one-third to one-half—roughly the disaster record of the 20th century. Increased demand for safe assets in response heightened disaster probabilities during major wars also explains why U.S. real interest rates were so low during the Civil War, World Wars I and II, and the Korean War. More recently, an increase in the perceived chance of worldwide conflict may explain the sharp decline in real interest rates after September 11 and the U.S. incursions into Afghanistan and Iraq. Real interest rates on 10-year U.S. Treasury index bonds fell from 3% to 4% before September 11, 2001, to an average of 1.8% for 2004-05—and have stayed low despite Fed's recent hikes in short rates.

The model offers other intriguing predictions. A higher disaster probability should raise the prices of hedges like far-out-of-the-money put options the Standard & Poor's 500-stock index as well those of precious commodities such as gold an diamonds. A recent study by Peter Kugler and Beatrice Weder of the University of Mainz explains why Swiss franc assets systematically underperformed assets denominated in nine other major currencies. They reasoned that the Swiss franc (a traditional safe haven) would appreciate in the event of a major war or depression. But since such events haven't occurred since World War II, the unused hedg premium built into the pricing of Swiss assets made them underperformers in an era of stability.

Right now, America is focused on the impact of a rare disaster called Katrina. But this event is unlikely to cost mo than $200 billion to $300 billion. The 15% or more GDP contractions in my analysis are of a larger order of magnitude. A 15% fall in U.S. GDP amounts to $2 trillion. I pretty sure that not even Washington, which is recklessly throwing cash at the Katrina relief effort, will be able to use up $2 trillion in resources. So, it'll take a much bigger event get a serious response from stock and bond markets. ■

Robert J. Barro *is a professor of economics at Harvard University and a senior fellow of the Hoover Institution (rjbweek@harvard.edu)*

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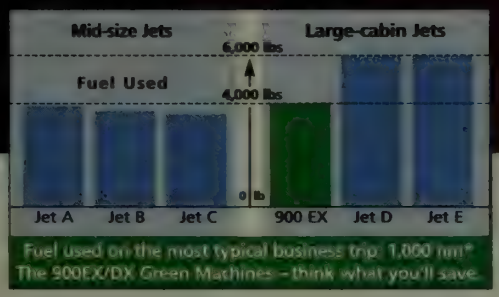

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Peering Into the Hedge Funds

HEDGE FUNDS ARE fast becoming the new titans of American finance. And nowhere is that newfound muscle more evident than at Cerberus Capital Management LP (page 100). With $16 billion of investor assets and control of more than 30 companies collectively raking in more revenues than Coca-Cola Co. and employing more people than Exxon Mobil Corp., Cerberus has become a force to be reckoned with. But because it's a hedge fund, Cerberus—and thousands of its investment-partnership brethren—wields its growing power with little oversight by securities regulators and limited visibility for investors.

That under-the-radar existence is about to change—at least a bit—thanks to new Securities & Exchange Commission Chairman Christopher Cox's decision not to overturn a pending hedge fund adviser-registration rule championed by his predecessor, William H. Donaldson. Cox's stance is sure to anger those wary of the expansion of even minimal federal oversight of this shadowy world of financial heavy hitters. But these secretive funds have simply become too large, and their investment reach too pervasive, for regulators to ignore.

Indeed, hedge fund investing is no longer the province of just the storied rich, who have long been eager to assume the big risks hedge fund managers often take—and the big fees they charge—to capture outsized returns. The feds saw no need to burden these capital pools with lots of Sarbanes-Oxley-style regulation, as long as they were confined to small groups of such sophisticated investors. But, increasingly, hedge funds are pulling in cash from the merely affluent and from public pension funds and retirement plans that are supposed to provide security for the golden years of millions of Average Joes. An estimated $860 billion is invested in some 7,000 hedge funds, and assets under management grew 30% in the past year. This expanding capital trove needs to be monitored—not only to help investors avoid fraudulent advisers but also to ensure that hedge fund actions don't roil U.S. markets.

> These increasingly huge capital pools need serious oversight

It's not an idle worry. In 1998, the Federal Reserve had to organize a rescue for Long-Term Capital Management after the highly leveraged hedge fund got caught holding $1.2 trillion in derivative positions when bond markets moved against its bets. Maybe today's hedge fund managers won't be as foolhardy, but there are a lot more funds out there now. So the cumulative risk of another shock to the financial system remains. One need only look at the recent scandal surrounding hedge fund Bayou Management LLC to recognize that investors could use more help making sure advisers are on the up-and-up.

To be sure, the mandatory SEC registration rule won't keep hedge fund investors from making lousy or inappropriate investments. The SEC's recent stricter oversight of mutual fund managers (much tougher than the hedge fund rule would allow) has so far yielded mixed results. And even the pending minor federal role in hedge fund oversight raises the prospect of moral hazard, where some investors may rush to hedge funds because they figure the feds will bail out any future hedge fund meltdown. Nonetheless, there is a larger public interest in knowing more about the managers and practices of these huge investment pools that increasingly function as virtual operating companies. Indeed, transparency is a major reason U.S. markets draw investors from around the globe, and the SEC hedge fund rule can only increase that visibility. For recognizing that, Chairman Cox is to be applauded.

Germany's Elites Failed the Public

GERMANY'S ELECTION on Sept. 18, which left no party with a clear mandate, shows that citizens of Europe's largest economy still aren't ready to jettison the status quo—even when the status quo includes 11.4% unemployment and growth of less than 1%. It's tempting to be disdainful of *das Volk* for clinging so tightly to an increasingly unaffordable welfare state. But some of the blame surely lies with the political and economic elite. To listen to the public discourse, you'd think reform is some kind of hellish ordeal, a journey into a world of mass poverty and social Darwinism.

But guess what: The changes Germany needs aren't that wrenching. Center-right candidate Angela Merkel, whose Christian Democrats fell short of the votes needed to form a workable coalition, advocated labor-law fixes that still would have left Germans with far more job protections than the Danes. Last time we looked, Copenhagen was a pretty cheerful, prosperous place.

Indeed, the great failure of Germany's elites—including the business community—is that they have allowed the debate to be framed by labor unions and left-leaning reactionaries who regard reform as a kind of economic chemotherapy. In fact, a moderate dose of change would free up the nation's considerable latent strengths, slow the investment shift toward Eastern Europe, and bring greater prosperity for all. Reform is a great opportunity for Germany—and for global growth, which would be bolstered if Europe's economic leader revved up. But until German political and business leaders learn to communicate the upside to the man on the street, Germany's economic malaise will persist.

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BY NANETTE BYRNES (P. 68)

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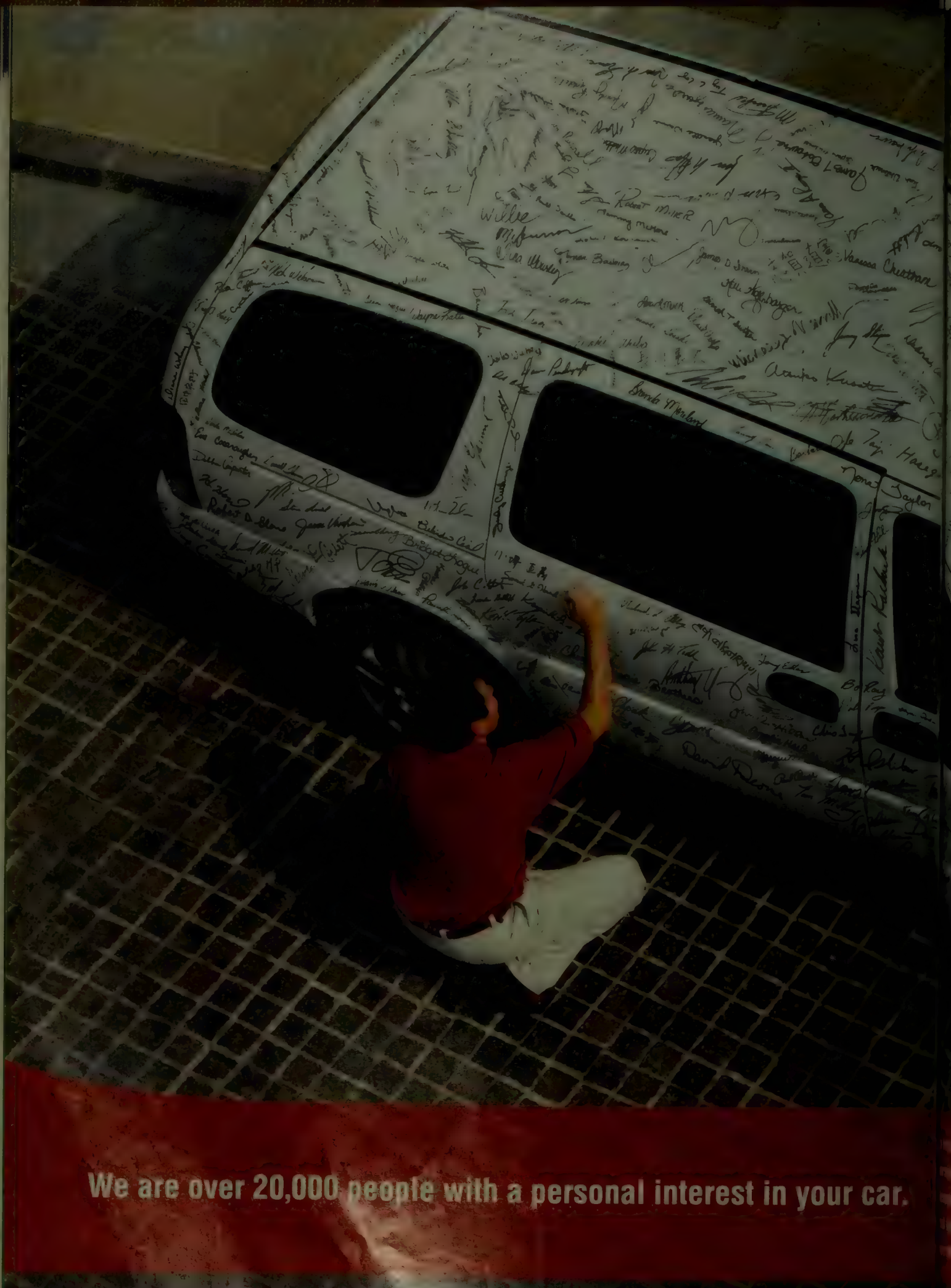
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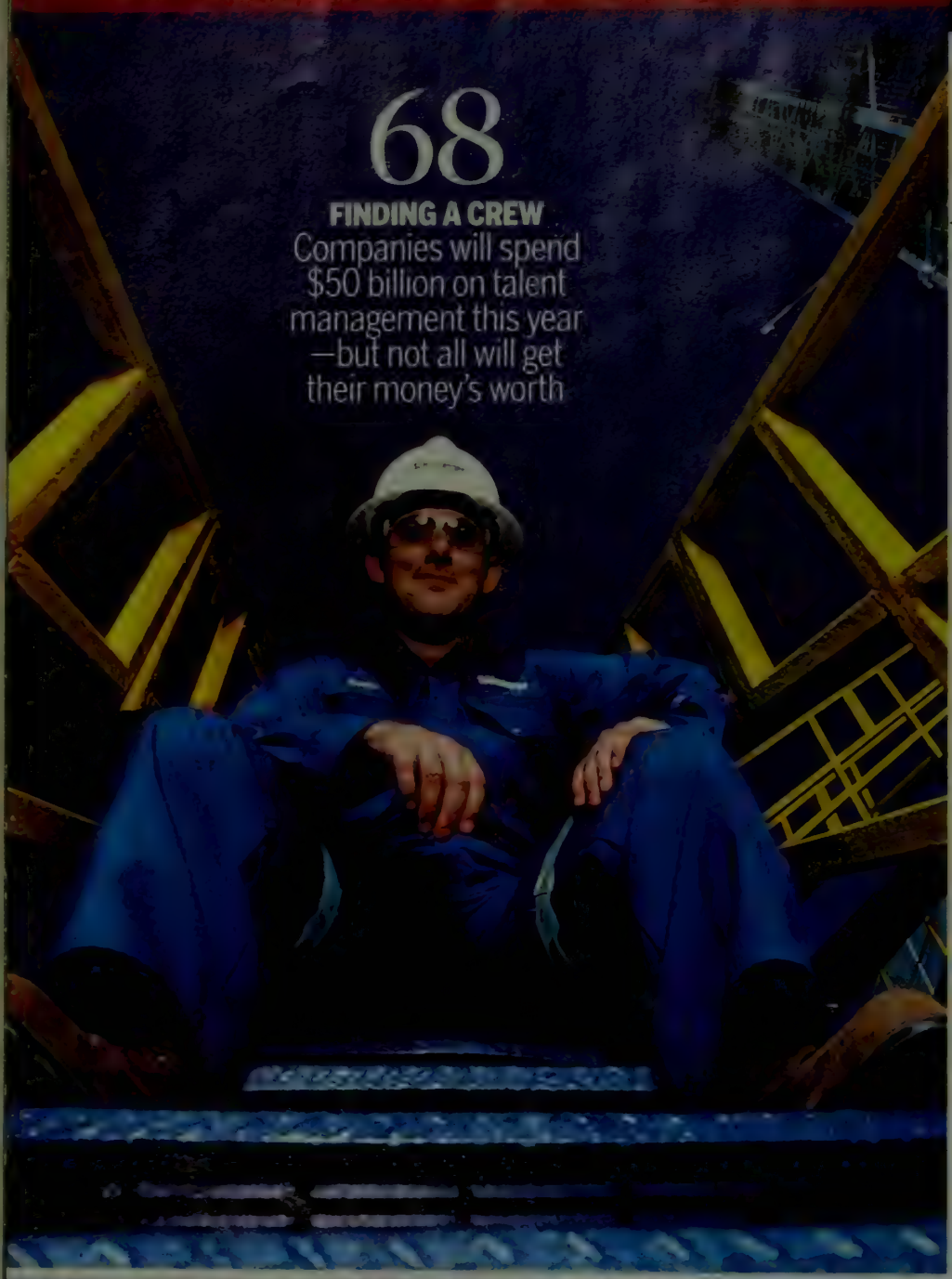

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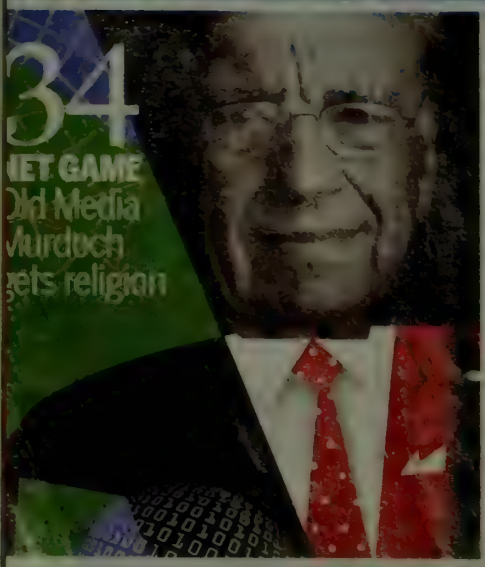
FINDING A CREW

Companies will spend $50 billion on talent management this year —but not all will get their money's worth



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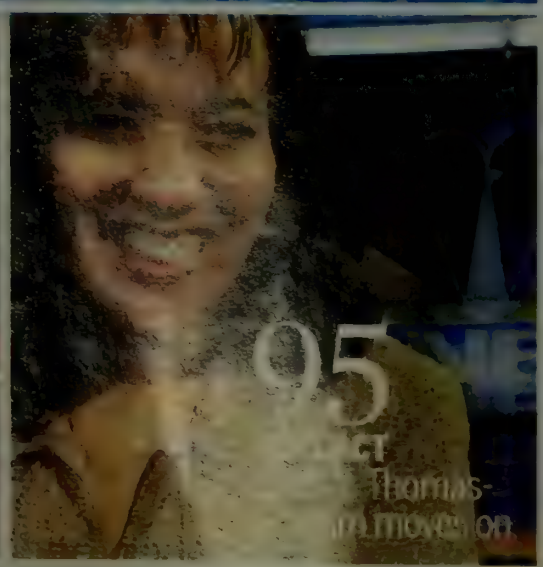

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A talented workforce—a company's gotta have it. But the pool is shrinking out there just as businesses need even more competent and creative employees. Yet most companies still don't know how to recruit, train, and hold on to the best people. Those that do—like Schlumberger, PepsiCo, and GE—have a secret weapon, and the returns to show for it

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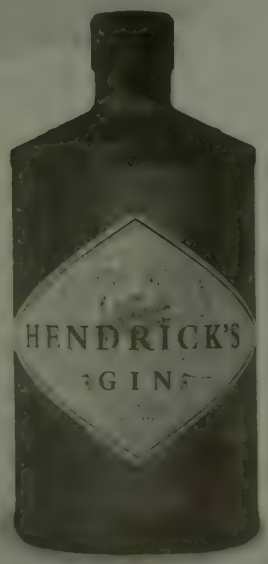

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The upstart chipmaker has been increasing its market share, and now its new round of dual-core semiconductors for servers will put even more pressure on industry leader Intel

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Taking the hit Swiffer beyond hard-surfaced floors presented plenty of obstacles to the design team, but they emerged with the CarpetFlick. Plus: A slide show revealing how the new product was born

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JP Front

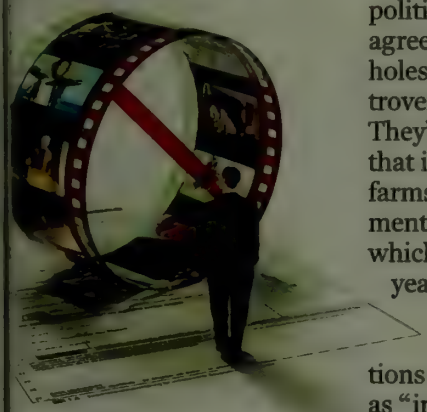
"'We have lost control,' that was [Greenspan's] expression."

–French Finance Minister Thierry Breton, quoting the Fed chairman on the U.S. budget deficit after they met. The Fed declined comment.

DITED BY DAN BEUCKE

OOPHOLES

GERMANY S ABOUT TO ELL 'CUT!'



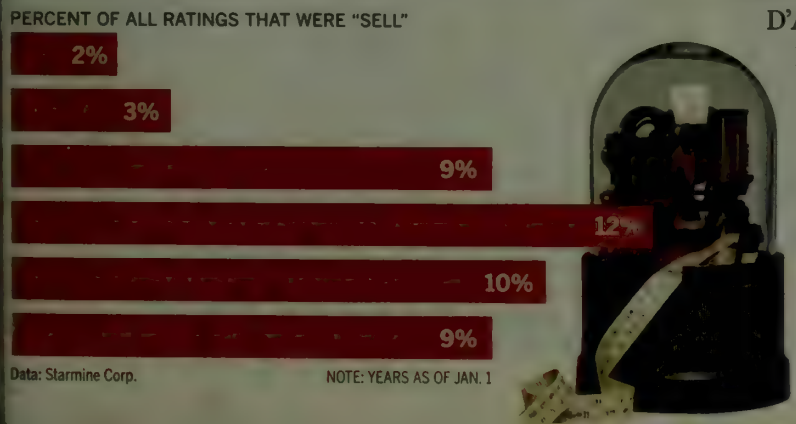
ERMANY'S deadlocked polit- l parties can't agree on who ould be the next Chancellor, t whoever it is seems cer- n to kill a tax loophole that s financed some of Holly- ood's hit films. So-called me- a funds, which let investors ite off 100% of their money front, backed titles such as *The Human Stain*, 2003 Oscar-winner *Monster*, and the new Pierce Brosnan vehicle, *The Matador*.

Desperate to rein in Germany's large budget deficit, politicians of every stripe agree that plugging tax loopholes for the rich is a noncontroversial way to do so. They're also eyeing funds that invest in ships, wind farms, and drug development. But the film funds, which raised $1.8 billion last year, attract the most scrutiny. A quirk in German tax regulations treats film investments as "immaterial goods." By taking out loans to cover the initial investment, investors can generate a deduction worth much more than 100% of the cash they put up. If the law changes, funds will have to attract investors by focusing on profits. Good luck finding those in Hollywood.

–Jack Ewing

HE BIG PICTURE

ACKSLIDING? Wall Street analysts rated a lot ore stocks "sell" after regulators targeted conflicts 2002. But lately, sells have been declining.



Data: Starmine Corp. NOTE: YEARS AS OF JAN. 1

GEARWORLD

Does Your iPod Lack Stamina?

THE CLOCK IS TICKING for millions of owners of older iPods. The problem: **Apple Computer's** iPods run on rechargeable lithium-ion batteries. Newer models are more efficient, but batteries for older models start degrading after 100 to 200 charges and need replacing after a year or two, says Gene Munster, a **Piper Jaffray** analyst. That means up to 2.2 million iPods sold from fall '03 to fall '04 may soon need new juice. Some owners are covered by a standard one-year warranty, while others have filed claims tied to a class-action suit. But many—like software developer D'Arcy Norman, who says his iPod fell from six hours of power on a full charge to just one after 16 months of daily use—have to pay to keep the tunes cranking. For $59, Apple offers an extended warranty or a replacement. Norman says he'll probably buy a third-party battery kit selling online for as little as $30. Meanwhile, Apple had its hands full last week handling complaints about broken or scratched screens on its newest iPod, the nano. Apple said a "vendor quality" problem caused screens to break in fewer than 0.1% of units sold. Customers with a defective screen can contact Apple for a free replacement. *–Elizabeth Woyke and Peter Burrows*

UP Front

MAD AVE

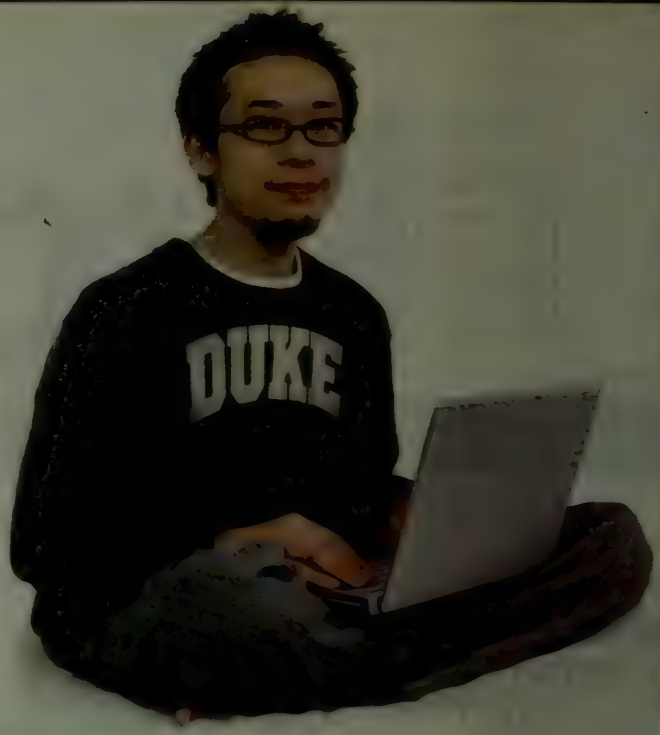
WHAT WOULD FRED AND ETHEL DO?

BICKERING NEIGHBORS Fred and Ethel Mertz from the '50s hit sitcom *I Love Lucy* are returning to television in all their black-and-white glory. But this time they won't be arguing over whether they should join Lucy's latest get-famous scheme. Instead they'll promote new Medicare drug plans in an ad produced by **PacifiCare Health Systems.** PacifiCare is one of many insurance companies gearing up to blitz the airwaves starting Oct. 15 with information about Medicare Part D policies. These health insurers will sell multiple drug plans to supplement traditional Medicare coverage —a hodgepodge of offerings sure to confuse seniors. Hence, the coming marketing push. "On average, PacifiCare can save folks over $1,000," Ethel says to her famously penny-pinching mate in the ad.

PACIFICARE AD Selling insurance from the beyond

Rather than casting look-alikes, Cypress (Calif.)-based PacifiCare bought the rights to use footage of the late Lucy actors, William Frawley and Vivian Vance, from their estates and **CBS.** Ad agency **Deutsch LA** taped voice actors reading the lines, then tweaked old video from the show to make it look as if Fred and Ethel are discussing Medicare. It's the same technology that allowed Tom Hanks to exchange pleasantries with former President John F. Kennedy in *Forrest Gump.*

PacifiCare is betting that nostalgia and tech wizardry will help cut through the Medicare clutter. Says Jacqueline Kosecoff, executive vice-president of specialty companies at PacifiCare: "For the 65-plus generation, Fred and Ethel really resonate." *–Arlene Weintraub*



TRADE WINDS

SWEATSHOP SWIPE After years of relative quiet, the anti-sweatshop debate is about to heat up. On Sept. 28, United Students Against Sweatshops (USAS) mounted demonstrations on 40 campuses demanding that universities force companies that license and make their sports clothes and other apparel to use only suppliers that pay a living wage and respect unions. USAS wants clothing companies to agree to pay higher prices to overseas factories that make college goods, which have annual sales of about $3 billion. Factories would have to boost wages, now about $97 a month in China. Jim Wilkerson, Duke University's director of trademark licensing and stores, calls the idea "workable," adding: "It would raise prices, but only by about 25¢ on a $30 garment." *–Aaron Bernstein*

REWIND

RISING NUMBERS, RISING RESISTANCE

Many businesses see a huge market in the nation's 11 million illegal immigrants ("Embracing Illegals," July 18, Cover Story). But, as illegals continue to pour in (page 64), there's a flip side: pressure on companies to withhold products and services. Outfits such as Friends of Immigration Law Enforcement are threatening mortgage lenders making loans to illegals with federal anti-racketeering suits. And an internal document from Greyhound Lines obtained by immigrant advocates last week outlines its prohibition on the sale of bus tickets to illegals.

Citing federal law, the Greyhound document warns employees that violations could get them fired—or arrested. It offers tips on how to spot a potential illegal immigrant smuggler (someone who wants to buy bundles of tickets and uses terms like "my cargo") or illegals themselves (people moving in single file or being led by a "guide"). A spokeswoman says the policy has been around for years and was beefed up after a bus company affiliated with Greyhound was indicted in 2001 by federal officials for trafficking in illegals.

Advocates for immigrants worry similar bans could set off a rash of racial profiling. "This is a very intimidating policy," says Arnoldo Garcia, senior program associate at the National Network for Immigrant & Refugee Rights. *–Brian Grow*

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UP Front

FACE TIME

ROBERT POLET

GUCCI'S CEO HAS THE LAST LAUGH

Fashionistas were atwitter last year when Gucci Group named Robert Polet CEO. Could Polet, head of ice-cream sales for Unilever, run a luxury group? You bet: In September, Gucci reported 76% higher operating earnings over first-half 2004, when ex-CEO Domenico De Sole and superstar designer Tom Ford were in charge. Polet, 50, has cut the time needed to get new collections to stores from several months to as little as six weeks. He has tightened financial discipline, threatening to sell smaller brands such as jewelry maker Boucheron if they aren't profitable by 2007. And he introduced focus groups: "Market research can never replace creativity, but insight into our customers helps our designers."

Several Gucci veterans were fired or resigned after clashing with the new boss. But Polet has the support of Gucci's owner, Paris-based PPR Group. In the end, he says, ice cream and $1,000 handbags aren't all that different: "You're selling pleasure." *–Carol Matlack*

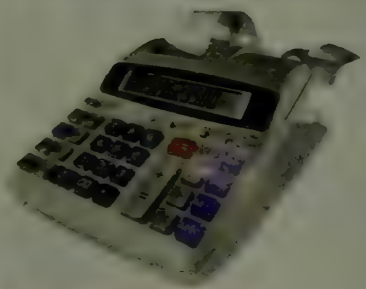
SOFTWARE

THIS MACHINE KNOWS JUST HOW YOU FEEL

YOUR CREDIT-CARD company may not be just recording your phone call for quality-control and training purposes, as the disclaimer says. It also may be analyzing your voice to detect rising anger—or lies. Advances in artificial-intelligence techniques mean companies can use audio files to identify everything from combative personalities to fraudsters. Their secret weapon: NICE Perform, a year-old software program from **NICE Systems,** which provides call-recording services to most of the 100 largest corporations. More than 40 companies, including **FedEx's Custom Critical** subsidiary, use the program to track as many as 26 verbal signals, looking for key words (such as "cancel") and emotions. The emotion algorithm takes a baseline read at the start of the call, measuring deviations in a caller's pitch, volume, and tone. These biometrics "work like a lie detector," says Eyal Danon, vice-president for marketing at the Israeli company.

Call-center managers can be alerted to frustrated customers so they can step in with a special deal or follow up with a conciliatory call. NICE says the system also could probably detect nervous vocal changes in people trying to commit ID theft or lying about a "stolen" car. Suspicious calls might go to a fraud-and-security unit, says Danon. A handful of insurance and financial services companies are testing that application.

Like lie detectors, NICE's system isn't foolproof. One idea for bolstering its detection powers is to store voice recordings from known fraudsters for comparison. *–Elizabeth Woyke*



JOB-HUNTING

REVENGE OF THE BEAN COUNTERS

THERE ARE SOME not new employers on campus: the Big Four accounting firms. In a survey of 30,000 [illegible] grads by **Universum Comm[illegible]tions** for its list of the 15 [illegible] Desirable Employers, **PricewaterhouseCoopers** came in No. 2 after **BMW. Ernst & Young** was No. 3, **Deloitte** No. 6, and **KPMG** was No. 14.

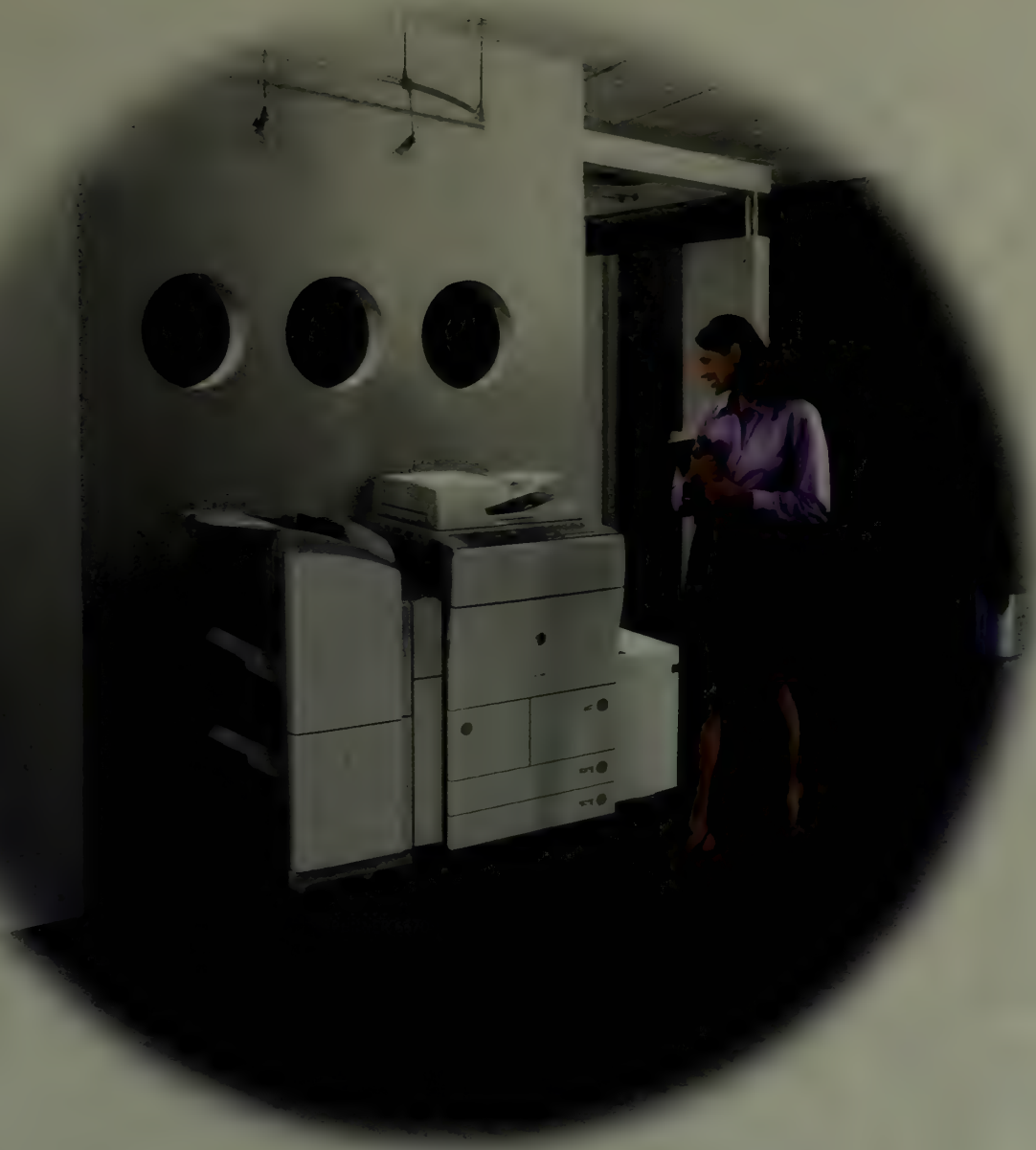
What gives? Accounting firms are top campus recruiters, and they offer attractive benefits, especially now that they need more bodies to keep up with the workload created by Sarbanes-Oxley. But Universum CEO Claudia Tattanelli says that in an odd way, scandals have enhanced the profession's draw: "The fact that an accountant can bring a whole company down or can keep one alive shows how accountants have a lot of power." *–Lindsey Gerdes*

THE STAT

53

The percentage of women who say they get an annual flu shot. Only 33% of men say they do.

Data: Zicam Flu Survey, commissioned by Matrixx Initiatives Inc.



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"When a 'big one' comes, the best first responder is oneself. We must retain, or regain, our basic independent living skills."

–Ray Huntington
Cutchogue, N.Y.

PREPARING FOR THE NEXT DISASTER

GOOD JOB ON "The next big one (Cover Story, Sept. 19)," but you forgot the biggest one: the atrophy of our basic skills in a technological society. The work of civil servants is necessary and many times wonderfully done, but when a "big one" comes, the best first responder is oneself. We must retain, or regain, our basic independent living skills.

–Ray Huntington
Cutchogue, N.Y.

THE NUMBERS IN *BusinessWeek*'s table "Sleepless nights," accompanying "The next big one," do not reflect the most recent information about the effects of the 1986 nuclear power plant accident in Chernobyl. The U.N.'s Sept. 5 report on Chernobyl concludes that of the more than 100,000 plant workers and personnel involved in responding to the accident, about 50 died as a result of radiation exposure. Among the 4,000 children who developed thyroid cancer as a result of absorbing radioactive iodine from the accident, nine died. The report also estimates that about 4,000 people could ultimately die of cancer caused by Chernobyl exposure. A toll of 4,000 possibl deaths from a nuclear power plant acc dent is still a disaster and unacceptabl but nonetheless represents the best-do umented figures for a chart such as th one you published.

–Scott Burne
Public Affairs Offic
Nuclear Regulatory Commissio
Washingto

AS THE CLOSEST Level I Trauma Cent to the World Trade Center and Wa Street, St. Vincent's Hospital Manhatta is acutely sensitive to preparing for ar other disaster ("New York takes anoth hit," Cover Story, Sept. 19). Most hospita receive only $75,000 a year [in terroris funding]. St. Vincent's has spent muc more than that to train and equip o own private EMS Paramedics, EMTs, an emergency-department physicians an nurses in the area of disaster prepare ness. This requires consistent repetiti drilling of disaster scenarios, including a unknown explosion, chemical attack, biologic outbreak.

On our own, St. Vincent's is trying raise $25 million for a new Rudolph Giuliani Trauma Center, with high capa

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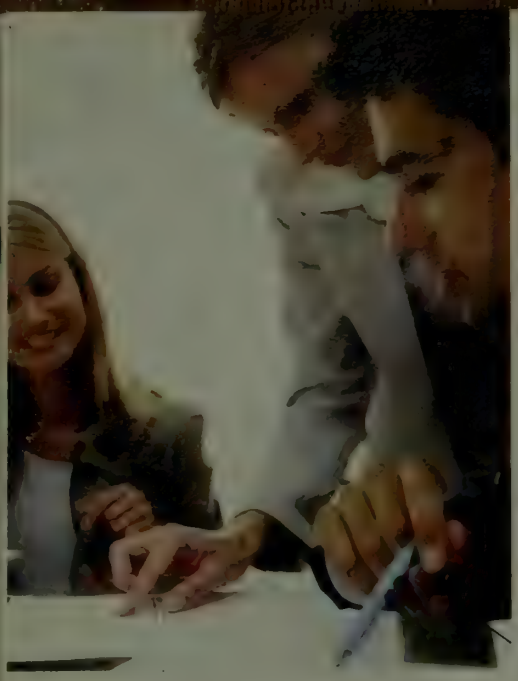

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CORRECTIONS & CLARIFICATIONS

"Boeing's strike: Go figure" (Workplace, Sept. 26) contained a typographical error and should have read: "The company's pension offer of $66 a month would add $16 million a year to its pension outlays.... The $80 the IAM wants would hike that by [not "to"] $29 million a year...." That would be 2.3% of the machinists' total wage-and-benefit expense, not 1%, as depicted in the accompanying table. [On Sept. 25, Boeing agreed to a three-year settlement of more than $270 million.]

"The real reasons you're working so hard" (Special Report, Oct. 3), should have said 31% of adults got less than seven hours of sleep on weekdays in 2001, not 34%. The source is the National Sleep Foundation.

In "A ray of hope for the fee fighters" (Finance, Sept. 12), the table should have said that a large-cap value account for the State of Alaska was managed by Invesco Institutional.

ity decontamination facilities, the ability to isolate patients exposed to a biological agent, and the capacity to handle a surge of patients from an accident or disaster.

–Richard Westfal, M.D.
Medical Director for
EMS & Disaster Preparedness
Saint Vincent Catholic Medical Centers
New York

AS A PSYCHIATRIC social worker with a background in disaster planning for children, I have published two papers on my Web site, pediatricdisasterplanning.com. A weapon of mass destruction or an industrial accident could spew toxins into neighborhoods and/or schools. As chaotic and tense as a decontamination scene would be, there has been little to no preparation for taking children through the process. Children require rapid decontamination—they are more susceptible than adults to toxins, biological agents, radiation, and hypothermia. In addition, if distraught parents are not adequately responded to, they will likely increase the morbidity and mortality of the event by interfering with decontamination and becoming contaminated themselves.

–Peter Sternberg
Chicago

OWN COASTAL PROPERTY AT YOUR OWN RISK

RE "LET THAT BE a warning" ("Katrina's wake," Cover Story, Sept. 12): Federal Emergency Management Agency buyouts of properties within floodway (not flood plains) are ongoing. Floodways are narrow strips of property within limited regions where river velocities make structural failure highly likely. But in coastal regions, where the potential for a storm surge is on a geological scale, what has been the market force in determining development is the withholding of flood insurance from these areas—tantamount to issuing an "at your own risk" sign to homeowners. Instead FEMA has pushed for building-code upgrades to include "velocity zones" for wave structure interaction.

My family has repeatedly lost everything to storms. We have not cried about lower payouts. We have gone on building and living there because the reward of our way of life is more valuable than the inevitable disasters. The issue becomes politically dramatic only when you make people feel that the federal government will pay for all damages dished out by Mother Nature.

–Roy S. Willett, Project Manager
FM&R Projects, KBR
Balad, Iraq

Editor's note: The writer, a civil engineer, is originally from the Mississippi coast.

THE FATHER OF WALKATHONS?

"SWEATING FOR DOLLARS" (Social Issues, Sept. 19) credits a Tacoma surgeon's idea 20 years ago for sparking the use of walkathons, bikeathons and other events for charitable causes. In April, 1980, a great Canadian named Terry Fox, after losing a leg to cancer, started a cross-country, fund-raising "Marathon of Hope" in St. John's, Newfoundland. Fox's intent to end his run on the country's west coast was cut short after 143 days and 3,339 miles when it was discovered that cancer had spread to his lungs. He died in June, 1981, one month short of his 23rd birthday. Every year marathons involving over 2 million participants worldwide are run in his name, raising money for cancer research.

–Ajay Jyo
Washingto

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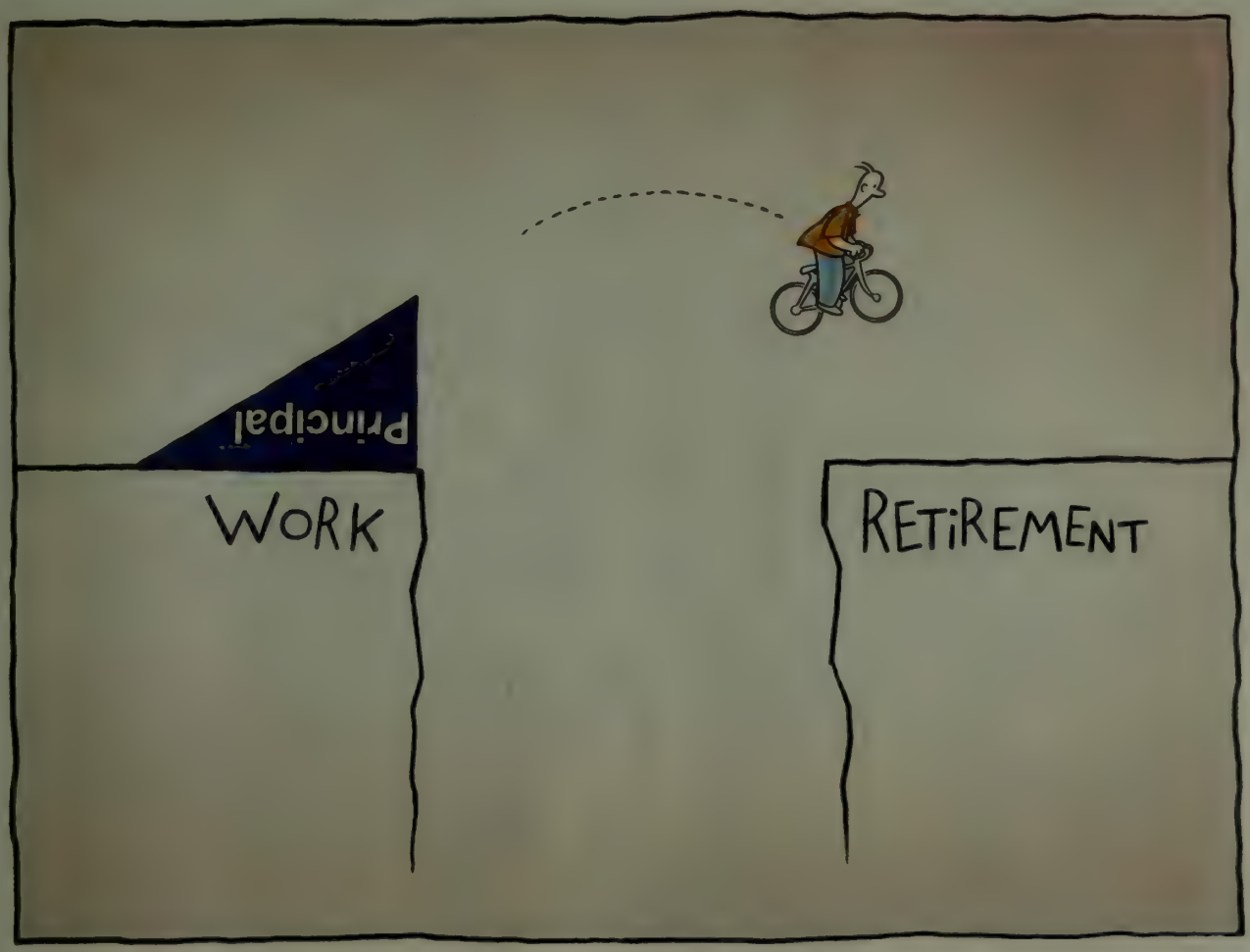

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Technology&You

BY STEPHEN H. WILDSTROM

Bless Both of These Backups

The hard drive on an aging desktop computer at home had been sending distress signals for months, but I was busy and ignored them. Then one day it took off for hard-disk heaven, taking with it, among other things, thousands of digital photos. But what could have been a real problem was no more than an annoyance.

That's because I practice what I preach: Everything on that PC was backed up—twice, in fact. So when my new desktop arrived, all I had to do was reinstall applications from their disks and download the data from backup. (I could have restored the applications from backup, too, but that might have reloaded all the junk the old computer had accumulated.)

The standard backup method used to be to copy everything onto removable media, such as floppy disks. But with the accumulation of photos, music, and video on today's massive hard drives, even the 4.7-gigabyte capacity of writable DVDs is too small. A reasonable alternative is to use an external hard drive linked to your computer with a USB or FireWire connection. One good choice is the Maxtor OneTouch II series, with models for Windows and Macintosh starting at about $150 for a 100-GB version. The included EMC Dantz Retrospect Express software, like any good backup system, both automates the process and allows restoration of both the latest version of a file and copies backed up earlier.

INSTEAD OF THIS, I chose two different routes to security, both somewhat more expensive than a simple external hard drive but each with distinct advantages. The first is continuous backup, which creates a copy of a file whenever it changes; the other is online backup, which stores the information in remote data centers.

Most backup systems copy files once a day, so any work you have done since the last backup could be at risk. I used a Seagate Technology Mirra Personal Server that plugs into a home or small-business network. Software, which can run on every Windows PC on your network, synchronizes files whenever they are changed, so your backups are always up to date. And you can use Mirra to give others on the network—or on the Internet, if you enable the feature—password-protected access to files of your choice. Prices range from $400 for a 160-GB version to $800 for 400 GB.

Two ways to protect yourself from data disaster

My second backup was Connected DataProtector from Iron Mountain. The software runs a daily audit of all the data on my computer, then encrypts the files needing backup and sends them off over the Internet to be stored at a secure data center. Connected offers a variety of plans, based on the amount of data transferred, starting at $80 a year. As we have been cruelly reminded, catastrophes happen. Off-site backup is currently the best defense against disasters such as floods or fires.

When I was ready to load files onto my new drive, I first retrieved everything backed up on the Mirra, because a local network is far faster than the Internet. But I had failed to include some key files—such as my Adobe Photoshop Album catalogues in the Mirra backups, and I was able to download these from Connected.

Had I been less scrupulous about backups, I still might have salvaged my data—at a price. Just to check that out, I sent my damaged hard drive off to Kroll Ontrack, which is a wizard at data recovery. It was able to reconstruct most of the data on the drive. But there were two disadvantages: The recovery would have cost about $2,000; and Ontrack could not recover the directory structure, so I would have faced some hours of work in getting files back into the right folders.

If Ontrack's recovery had been the only way to save that data, the $2,000 might have been well worth it. But the experience was a strong reminder that prevention in the form of regular backups is a lot better than the cure. ■

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MediaCentric

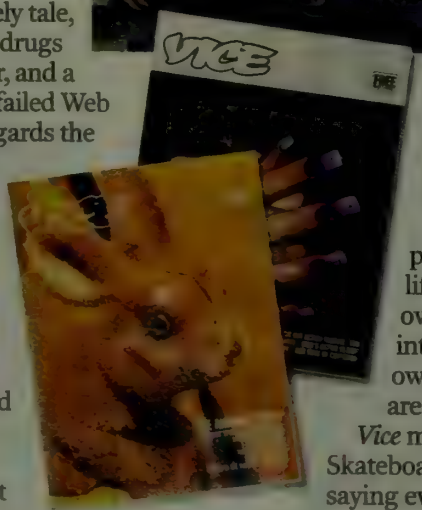
BY JON FINE

Media, Marketing, and Advertising in the 21st Century

The Rewards of Spreading *Vice*

A picturesque but semi-toxic September sunset, all hazy oranges and pinks, hangs over an industrial block near the Brooklyn waterfront. Beneath it two men approach a clutch of scruffy, T-shirted early-twentysomethings, who slouch and smoke cigarettes in front of an unmarked warehouse. ¶ "We are trying to say: 'We are going to take over the world,'" says one of the men, who sports glasses with improbable white frames. "And these are the guys who are going to do it," finishes his long-haired friend, gesturing at the smokers. Both squint slightly, as if they've just emerged from a tavern's artificial darkness. Which they have.

The guy with the glasses is Suroosh Alvi. The long-hair is Shane Smith. In 1994, along with their pal Gavin McInnes, they founded a free publication in Canada called *Vice*. Since then, *Vice* has gone from tabloid to glossy monthly magazine to international mini-empire. The smokers are some of *Vice*'s 120 employees. All this adds up to an unlikely tale, encompassing gargantuan amounts of drugs and alcohol, all manner of bad behavior, and a disastrous dot-com-era alliance with a failed Web media company. *Vice*, which reliably regards the world with unbridled ridicule, is often so far and away the funniest print publication in the world that it's sort of embarrassing to compare anything else with it. And unlike former claimants to that title—such as *Spy* or *Might*—*Vice* is comfortable enough with modern media and marketing to leverage its cachet into a multi-tentacled business play.



BAD BEHAVIOR Hipster magazine co-founders Smith and Alvi

I WON'T BE THE FIRST TO POINT OUT that the phrase "the Martha Stewart of…" is the ultimate media cliché. But embodying it remains the ultimate media fantasy: Your content resonates so well with consumers that it flourishes commercially across all media, and maybe even retail, channels. This is harder than it seems, which is why you don't subscribe to *60 Minutes* magazine or watch *US Weekly Tonight*. But *Vice*, now based in Brooklyn, honed a sensibility that works in multiple forms. It's published in 13 countries. (The U.S. edition, with an unaudited circulation of 175,000, is the largest.) *Vice* stores hawk clothes and accessories in Los Angeles, New York, and Toronto. There's a deal for a *Vice* record label with Atlantic Records, which, thanks to one band of the moment (The Bloc Party), was just renewed.

Last year, VH1 made an offer to air a show based on *Vice*'s scathing "Dos and Don'ts" fashion column, the apotheosis of the *Vice* voice that, regrettably, can't be quoted herein. (*Vice* turned down VH1 and is discussing a *Vice*-branded show with Spike TV.) There is addVice, a street-marketing arm that counts Virgin Mobile among its clients. In 2006, *Vice* plans to launch Virtue, a marketing company offering traditional ad agency services. This year the privately held *Vice* will post profits of around $4 million on revenues of about $14 million, says Smith.

Like pornography, the *Vice* zeitgeist is hard to define, but you know it when you see it. It blends hip-hop and white postcollegiate hipsterism. (In all twentysomething lifestyle plays, music is lingua franca and lifeblood.) It's overlaid with frank sexuality and familiarity with intoxicants, and suffused with the grotty-chic of a *Vice*-owned London pub. "Stars go there, and we're like: 'Why are you here? [This place is] terrible,'" says Smith.

Vice mores may not fit with the mainstream, but Nike Skateboarding, Levi's, and Absolut advertise in it. "I'm not saying everyone who buys [Nike Skateboarding] is [expletive] up and subscribes" to what *Vice* does, says a Nike spokesman, "but the general sensibilities line up pretty nicely."

Of course, a magazine that blithely dismisses baby boomers with "almost everything bad about today can be traced back to them" isn't too concerned with finding a broad audience. Cracking the mainstream was never *Vice*'s point. Big media players practically split themselves in two trying to turn one success into many, but three Canadians with dubious pasts look as if they've figured it out. They've made *Vice* the Martha Stewart of the cheap drugs and sex set. ■

E-mail: jon_fine@businessweek.co

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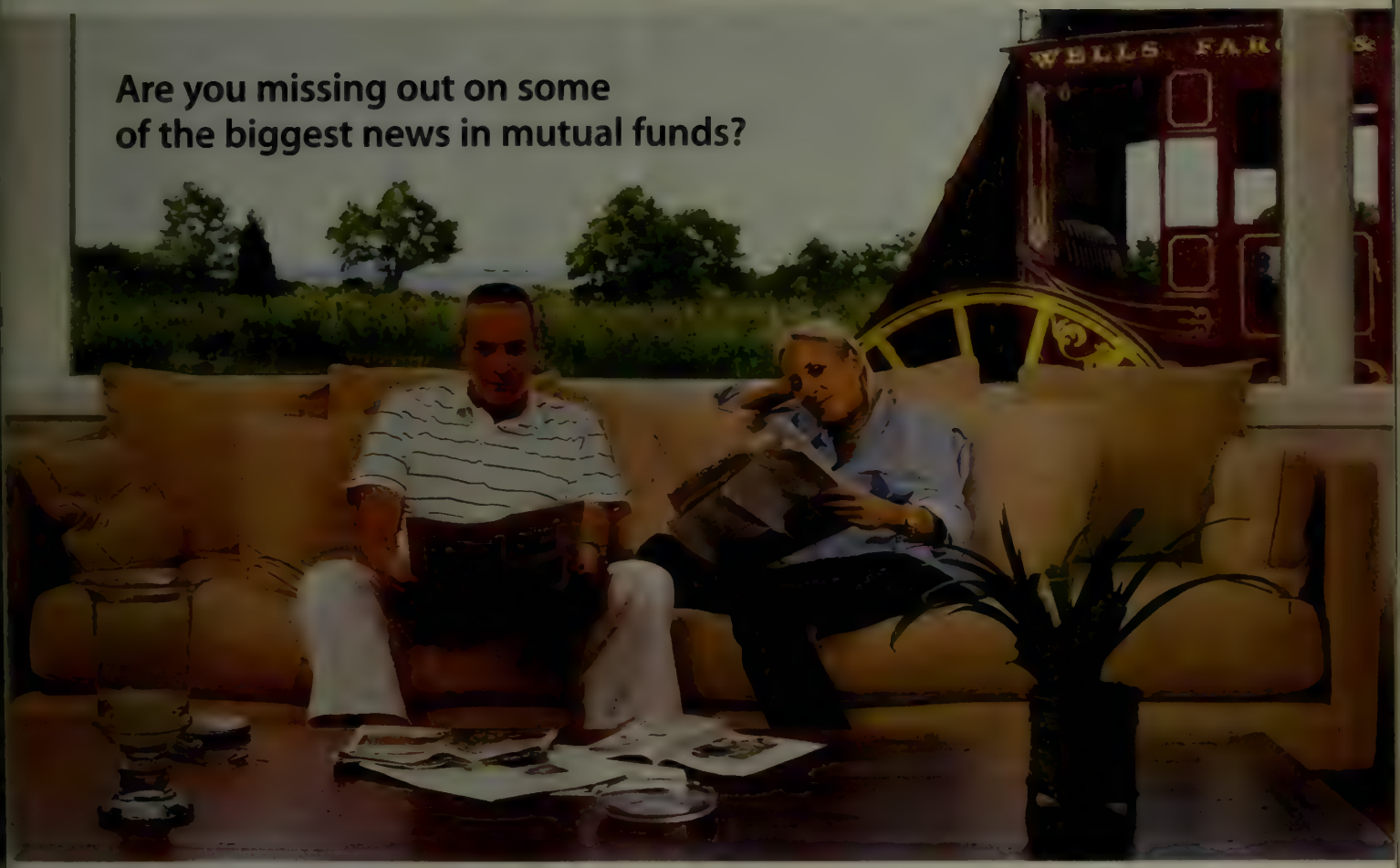

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The Barker Portfolio

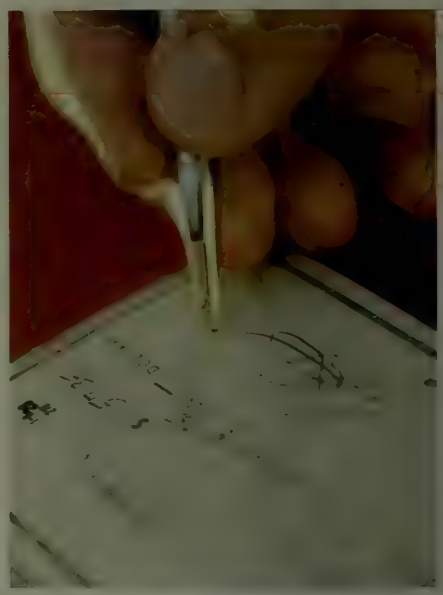
BY ROBERT BARKER

A Big Deal Under the Radar

One minute, eBay is buying Internet phone service Skype. An hour after that, Wachovia buys auto financier Westcorp. Oracle takes out Siebel Systems just 32 minutes later. All this came days before investors began drooling for details of a possible Microsoft deal for part of Time Warner's America Online. It's deal mania, once again, and in every mania some things get neglected—sometimes promising things.

This time the $4.5 billion merger of Fidelity National Financial's information services unit into credit-card and check processor Certegy has been widely overlooked, despite being valued at more than the Skype, Westcorp, and Siebel deals. No wonder, perhaps, given each party's low profile. I mean, what mental picture does the term "Certegy" create? For its part, Fidelity National, with a $7.6 billion market capitalization, may be the single biggest anonymous company. It has nothing to do with Fidelity Investments, the closely held mutual fund behemoth of Boston, yet in its fields, it's every bit as dominant.

BASED IN JACKSONVILLE, FLA., Fidelity is the nation's No. 1 title insurer, writing about one in three real estate title policies. It also offers a raft of specialty insurance, such as home warranty lines, while running a rich collection of data processing, outsourcing, and software operations for the world's banks, real estate brokers, and other financial intermediaries. In the last four quarters, Fidelity netted $1 billion on $8.6 billion in revenue, up from $5.1 billion in 2002. Ronald Muhlenkamp, whose market-beating, $3 billion Muhlenkamp Fund holds nearly 2 million shares, has kept a big stake since 1991, with some shares at a cost of $1.50. Lately, they're going above 44, but he told me he has no plan to sell: "These folks have been great stewards of our assets."



Fidelity's stock swap with Certegy amounts to taking Fidelity's wholly owned information services unit public, without resorting to an initial public offering. Fidelity had been mulling an IPO, as it has been frustrated that investors haven't valued its diverse operations as highly as it believes they should. So, parallel to the Certegy deal, Fidelity also is moving to spin off to its own stockholders an 18% stake in the mainstay title insurance business. This new public company, to be called Fidelity National Title Group, is expecting to begin trading on the NYSE in October. Once the dust settles, stock in the parent, Fidelity National Financial, will keep trading, plus those of its two offspring, Fidelity National Information Services and FNTG.

So which might you want to own? Arguments can be made for each. As a consolidator of information-technology services, FNIS figures to be a faster grower, while FNTG may have a more entrenched business. Yet to me, neither is as attractive as the parent, for a simple reason. Fidelity National Chief Executive William Foley has been building up the company since 1984. That's where his biggest interest—more than 8.8 million shares and options on shares—lies. In allocating resources, costs, and benefits among the three entities, the parent is unlikely to suffer. Already, for example, in the title insurance group's spin-off, the parent is keeping a special class of supervoting shares for itself. But it is leaving the costs of the distribution with the child.

As one public company today, Fidelity National trades at a multiple of 12 times the Standard & Poor's estimate of 2005 earnings. But the sum of its three parts stands a good chance of rising noticeably. ■

E-mail: rb@businessweek.com

The Fidelity National Financial Family

NAME	SYMBOL	RELATIONSHIP	REVENUE	EBITDA**
Fidelity National Financial	FNF	Parent	$8,643	$1,637
Fidelity National Title Group	FNT	82.5%-owned by parent	5,925	939
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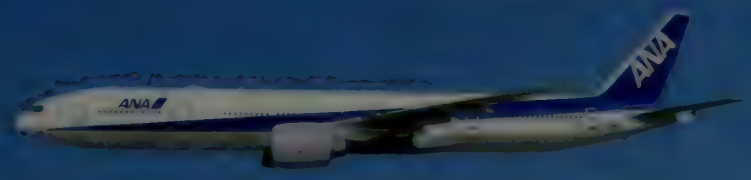

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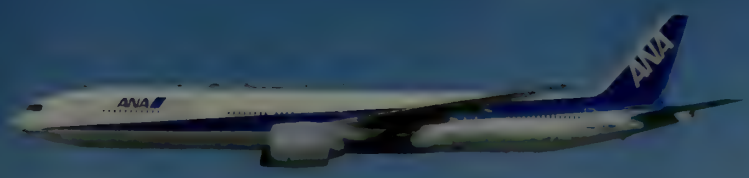

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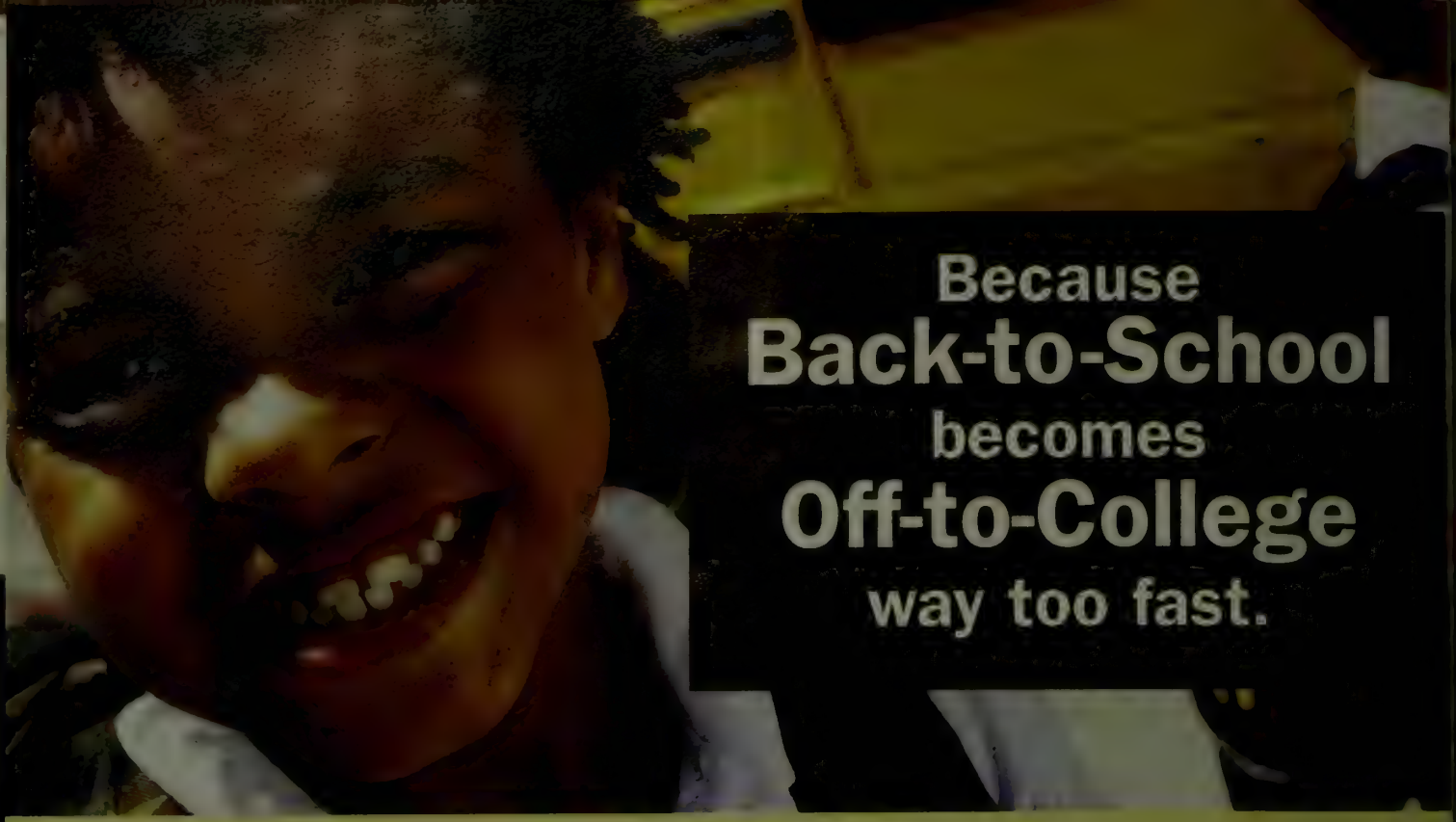

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BY JAMES C. COOPER & KATHLEEN MADIGAN

Walking a Fine Line On the Way Out the Door

Greenspan's final Fed decisions are complicated by the two hurricanes

U.S. ECONOMY The easy part of the Federal Reserve's job is about inished. After a series of 11 interest-rate hikes, Fed policy is at or close o the point where it is not helping growth. Now comes the hard part. Policymakers have to decide whether they can hold steady at a neutral evel, or if new business conditions dictate that the Fed must begin to an against the economy's momentum. It's a crucial call at will be made even more complicated by rising energy sts, supply disruptions from two hurricanes, and an nanticipated rush of fiscal stimulus. As if that weren't ough to deal with, the Fed will have to consider all this hile making the transition to a new regime, when Fed airman Alan Greenspan steps down on Jan. 31.

Against this backdrop, the chances of a policy mistake ve grown substantially. Tightening too much could ttle the financial markets and knock away the supports der housing, which has been a major driver of nsumer spending, according to a new study by the Fed. consumer pullback would, in turn, reinforce recent siness jitters over the impact of costlier energy. The ult would be a severely weakened economy—or worse.

But at the same time, with energy prices high, labor rkets tight, and slower productivity growth lifting unit or costs, staying at neutral could allow inflation outside food and energy to pick up rapidly. A surprise in the core lation numbers would force a harsh interest-rate ponse by the Fed that could also rattle the markets and und the economy. Given that the policy committee on ot. 20 recorded its first dissenting vote in more than two rs, the next several Fed meetings promise to be lively airs—and extremely important to the outlook.

HICH WAY WILL THE FED GO? The statement after Sept. 20 meeting strongly suggests that for now icymakers are willing to err on the side of too much traint, rather than too little. Contrary to market ectations, the Fed gave no hint that it was ready to p lifting rates, even amid new energy uncertainties. Indeed, in a shift from past views, the Fed said "higher ergy and other costs have the potential to add to lation pressures." That change is notable, because viously the Fed seemed more sensitive to the potential ect of costlier energy on growth than on inflation. The d market had agreed with that assessment, pushing vn long-term rates even as oil prices soared.

What seems different now is that high energy prices proving to be more permanent than in the past. As a ult, businesses may try much harder to mark up their es to cover the higher energy bills. Previous Fed statements had characterized inflation expectations as "well contained," but the Sept. 20 assessment was tweaked to say they were simply "contained." Worries about core inflation have helped to push up the yield on a 10-year Treasury note to 4.3% from 4% in late August.

And inflation concerns are spreading. In September, the University of Michigan's survey showed a sharp rise in consumers' inflation expectations for the coming year, and the anticipated inflation rate for the next five to ten years rose to 3.1%, the highest reading in more than four years. Plus, investors' expectations about inflation can be approximated by the difference between the market yield on a 10-year Treasury and the inflation-adjusted yield for a Treasury Inflation Protected Security. This gauge has been moving up in recent weeks.

CAPITAL SPENDING IS STILL ON THE RISE

Data: Census Bureau, Global Insight Inc.

The supply shocks from Hurricanes Katrina and Rita to areas outside of energy add to potential core price pressures. Supply shocks are different from demand shocks, and they present an especially thorny problem for the Fed. Unless overall demand falls by as much as the loss of output, shortages and production bottlenecks will push up prices across a broad range of goods and services. But a lasting slowdown in demand doesn't seem likely in the second half. Labor markets remain healthy, businesses are stepping up their orders for capital goods (chart), and a surge of government money is financing the cost of cleanup and rebuilding,

THE OUTLOOK FOR 2006 doesn't call for much of a slowdown in demand either, according to a recent survey of 43 forecasters taken by the National Association for Business Economics and presented at the NABE's annual meeting in Chicago. They look for the economy to grow 3.5% over the four quarters of 2005, and growth will average 3.3% during the second half. The economy is

then expected to grow another 3.4% in 2006.

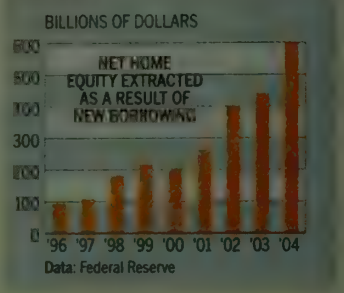
Consumers are sure to have a negative impact on demand, but not to the degree implied by the plunge in September consumer confidence. In the wake of Katrina and spiking gasoline prices, the Conference Board's index dropped 18.9 points last month, the third-largest monthly decline on record. Households sharply downgraded their assessments of both their present economic conditions and their prospects for the future.

However, consumer confidence could very likely rebound as long as labor markets remain healthy. To be sure, the Labor Dept.'s September report on payrolls will look dreadful. However, outside of Katrina's downdraft, the job markets show no signs of deterioration. Excluding Labor's tally of weekly claims for unemployment benefits in the storm-affected areas, claimant activity so far in September is averaging a shade over 300,000 new filings per week. That is slightly below the average level during the four weeks prior to Katrina.

BUSINESS CONFIDENCE does not appear to have been shaken. Based on a special post-Katrina survey of CEOs by the Business Roundtable, executives believe the storm and its aftermath will negatively affect their businesses, but only 4% said the effect would be "strongly negative." On balance, sales expectations slipped, as did capital-spending plans, compared with pre-Katrina readings, but hiring plans showed barely any deterioration. Importantly, companies involved in the hurricane recovery, such as energy, equipment manufacturing, and construction, have plans to increase their hiring.

If demand stays healthy, the Fed will have to keep hiking rates by perhaps more than the single quarter-point hike that the markets now expect. However, that could jeopardize the Fed's most delicate goal: cooling off the housing boom without creating a bust. Fed research by Greenspan himself shows that households extracted nearly $600 billion from the value of their homes last year as a result of new borrowing. The amount, which was nearly triple that taken out in 2000, equaled 6.9% of aftertax income (chart). Clearly, the housing boom has been an enormous factor in the resilience of consumer spending. If home prices cool off too much, the resulting loss in spending could deal a blow to the economy.

HOW HOME VALUES HAVE FUELED SPENDING



Before Katrina, it seemed as if the Fed had great latitude in deciding monetary policy. But now, the uncertainties over energy, business confidence, consumer behavior, and housing mean that the Fed has much less leeway and faces a greater risk at making a policy error. Given the intense pressure looming in coming months to make the right decisions, Greenspan might even welcome his retirement when it comes. ■

BRAZIL

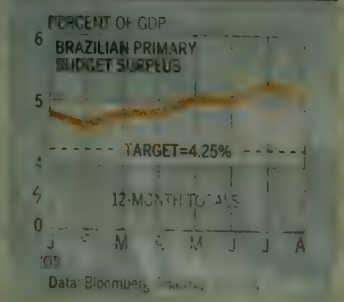
Playing by the Numbers

DESPITE A WHIRLWIND of political scandal, Brazil's economy is proving resilient. But that resolve will be increasingly tested if a growing controversy over alleged bribes and vote-buying in the executive branch and Congress complicates the political panorama as Brazil heads into next year's presidential elections.

President Luiz Inácio Lula da Silva's approval ratings have plunged, and on Sept. 27 five members of Congress from his own Workers Party (PT) left the party, leaving the President without a majority in Congress. Several of his top officials have resigned in connection with an alleged vote-buying scheme.

Nonetheless, da Silva shows no sign of relaxing his focus on fiscal discipline in order to regain popularity. On Sept. 23, the President signed an executive order overriding several parts of the 2006 budget law passed by Congress, including a provision that would have prevented the government from reducing spending plans established by lawmakers in the budget.

AHEAD OF THE GAME



In part to stem possible investor concern over Brazil's current political turmoil, Finance Minister Antonio Palocci wants to raise the primary fiscal surplus target, which excludes interest payments on government debt. The current target for this year and next is 4.25% of gross domestic product. Steady economic growth and fiscal discipline have the primary surplus at 5.1% of GDP in the 12-month period through August.

But three years of fiscal austerity have eroded support among members of da Silva's own party. The scandals will simply make it more difficult for the government to raise the target. That means Brazil may miss a chance to trim its public debt, now at 51.3% of GDP.

More election-year spending could also halt the present trend of slowing inflation and force the central bank to cut interest rates less aggressively. After a quarter-point interest-rate cut to 19.5%, in September, the Banco Central do Brasil is expected to follow with a series of half-point cuts. The slower the bank cuts, the costlier it will be for Brazil's government, since a large share of its debt is linked to short-term rates. ■

-By James Mehring in New York with Geri Smith in Mexico City

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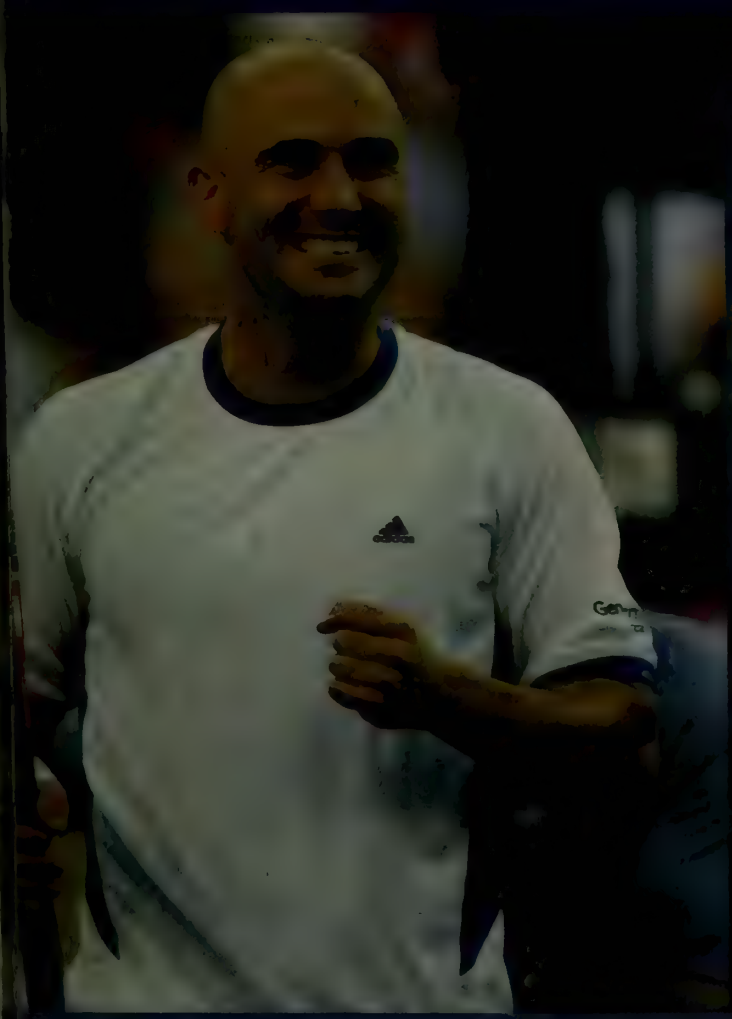

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News Analysis & Commentary

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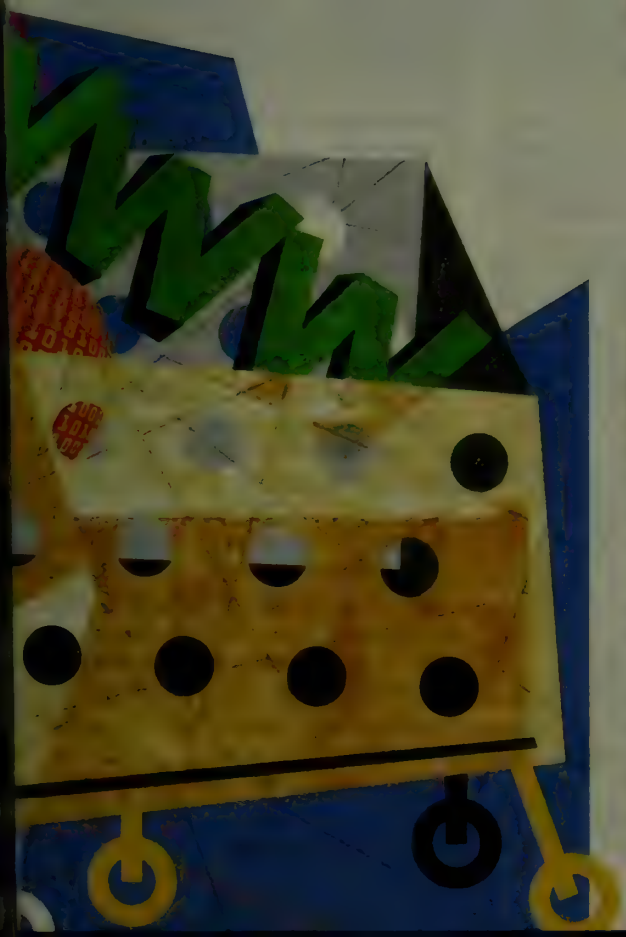
E INTERNET

MURDOCH'S WEB GAMBIT

He's on a multibillion-dollar buying binge—and Net guru Ross Levinsohn is picking the merchandise

BY RONALD GROVER



IT WAS 3 A.M. ON THE WEST Coast. While lawyers and bankers were haggling over the details in New York, Ross Levinsohn was on an Internet-service phone in the den of his West Los Angeles home offering last-minute directions on a $650 million deal. The pressure was on: News Corp. Chairman Rupert Murdoch was hustling the prize, Internet gaming and entertainment site IGN Entertainment, away from fellow mogul Sumner M. Redstone, Viacom Inc.'s chairman and CEO. Levinsohn, only seven weeks earlier elevated to head of the Fox Interactive Media unit, had been talking to IGN. Suddenly, he learned that Redstone was nearing completion of due diligence to buy the site. Levinsohn and team turned up the heat and won the contest over the next 48 hours. "We pride ourselves on moving quickly as an organization," said News Corp. President Peter Chernin after IGN was safely in his camp.

Murdoch's Internet strategy has been simple enough: buy, buy, and buy some more. Since July he has spent $1.3 billion to purchase IGN, along with Intermix Media Inc., which controls social networking site MySpace.com, and sports online network Scout.com. But if Murdoch is doling out the cash, it's Levinsohn, a onetime sports publicist, who has been drawing up the cyberspace playlist. Until recently, Levinsohn had been Fox's in-house jock, overhauling its Fox Sports online operation to make it a competitor of

PHOTOGRAPH BY JOHN S. ABBOTT; PHOTO-ILLUSTRATION BY WILLIAM RIESER

ESPN.com. Now, as Murdoch redesigns News Corp.'s Internet future, Levinsohn, 42, will be responsible for transforming the company's far-flung TV, Hollywood, and newspaper properties into cybermagnets. "He's the guy we're relying on to make it work," says Chernin.

ALARM BELLS

MURDOCH'S AMBITIOUS online gambit has been brewing for months, say News Corp. insiders. The 74-year-old mogul was spurred into action, they say, by a Carnegie Corp. survey that showed 44% of 18- to 34-year-olds get their news from the Web, vs. 19% from newspapers. Murdoch's friends were chiming in, too. Microsoft Corp. Chairman William H. Gates III was telling him—and the world—that Internet advertising would climb to $30 billion in three years, roughly twice what it is today. This set off alarm bells for Murdoch, whose businesses get a healthy chunk of their $23.9 billion a year in total revenues from advertising. It all pointed to an overhaul of News Corp.'s stable of Internet sites, including those tied to its Fox Sports and Fox News cable channels that appealed to an over-30 crowd but not to the younger folks flocking to the Net and wireless digital. "We needed to get younger—and quickly," says Chernin.

For Chernin, Levinsohn was the perfect guy to jump-start the effort. After working in the sports world, including a brief tour with the ProServ Inc. sports agency, Levinsohn was the closest News Corp. had to an Internet heavyweight. He ran the news operation for CBS Sportsline.com before heading off to AltaVista Co., a portal that's now owned by Yahoo! Inc.

At News Corp., Levinsohn shone. Assigned to struggling Fox Sports online in 2001, he remade the money-losing operation by closing regional sites to go national. He signed on with RealNetworks Inc.

> "The trick is to give these folks content without them thinking it comes from Big Fox"
>
> *–Ross Levinsohn, President, Fox Interactive Media*

and MSN to provide them sports data and within three years had boosted traffic from 800,000 to 10 million unique visitors a month. In one of Fox's most innovative deals, it merged its fantasy sports operation—a passion for Levinsohn—with that of Paul Allen's *The Sporting News*, gaining 300,000 subscribers without paying for them. *Sporting News* gave Fox Sports articles and stats, while Fox promoted the site with a half-hour show on the Fox Sports TV channel. Levinsohn "is a smart, resourceful guy who does a lot with what he has," says Houlihan Lokey Howard & Zukin investment banker Jon Richmond, who first hired Levinsohn in 1999 when he ran Murdoch's first Internet effort, News Digital Media, which closed in 2001.

This time around, News Corp. is counting on a whole lot more folks with broadband—up to 53% of the U.S. by 2009, as projected by PricewaterhouseCoopers. To draft a battle plan for capturing that growing audience, Levinsohn went underground. Closeted with seven other Fox Internet executives in March, he settled into the W Hotel near University of California at Los Angeles for a week, coming up with a list of targets in a conference room full of computers. Some, such as Scout.com, were on his list at Fox Sports. Others, like blinkx, a search engine that collects video and audio clips, were ideal for News Corp.'s huge collection of TV shows, trailers, and news segments. Not all panned out: The blinkx talks have broken down, and News Corp. walked away from a bid for Internet phone provider Skype Technologies. Levinsohn joined Murdoch and his son, James, in those talks. But Murdoch, who has plans to spend $2 billion, if not more, says two smaller deals may be coming within the next few weeks.

Melding News Corp.'s new Internet acquisitions with its stable of traditional media properties won't be a snap. For starters, Brad Greenspan, a 10% owner in MySpace parent Intermix Media, says he is trying to line up partners for a rival bid. The board has shot down Greenspan's overture, but shareholders will vote on it on Sept. 30. News Corp. executives aren't commenting on a possible new bid.

But Murdoch isn't slowing down his cyber invasion. After agreeing to buy IGN, the media tycoon gathered four dozen senior executives, including folks from MySpace and IGN, for a retreat at the Carmel Valley Ranch, near Murdoch's Northern California spread. There Levinsohn outlined the overall strategy to build on the 70 million unique monthly users who click onto News Corp.'s old and newly acquired sites. Many are under 30, so Fox has to make sure users aren't alienated by a Big Media footprint on the hip new acquisitions. "The trick is to give these folks content without them thinking it comes from Big Fox," says Levinsohn. "It has to be organic," adds MySpace CEO Christopher T. DeWolfe. "Our people can tell the difference."

Murdoch may be in a hurry to conquer the Net, but Wall Street is apparently perplexed by his new dash. "If there's a strategy there, I don't see it yet," says Fulcrum Global Partners LLC analyst Richard Greenfield. Both Chernin and Levinsohn admit they're still feeling their way. Yet News Corp. has won a massive number of new eyeballs in a short period, thanks to a onetime jock who says he used to have a five handicap in golf. That was before the late-night calls, nonstop travel to check out News Corp.'s latest acquisitions, and the sprint of devising a new and improved Internet plan—fast. ■

Getting Internet Religion

News Corp. founder Rupert Murdoch, who built his empire on Old Media newspapers, is suddenly infatuated with the Net. Here's why he likes the Web:

ADVERTISING

A Murdoch footprint on the Internet will let him tap into the thriving ad climate in cyberspace at a time when ad revenues for traditional media are slowing.

AUDIENCE

His TV properties like Fox, Fuel, and FX, already draw plenty of under-30s. But the young users of sites such as MySpace.com and IGN.com are growing much faster.

PROMOTION

With the Net, Murdoch can more easily promote his other properties. His Fox studio just sent out 10 million e-mails to MySpace users with a trailer for the movie *Transporter 2*.

CONSUMER ELECTRONICS

THE LESSONS FOR SONY AT SAMSUNG

Among them: Listen to customers, partner closely, and move at warp speed

WHEN SONY CORP. CEO Howard Stringer unveiled a major restructuring in Tokyo on Sept. 22, the market yawned. Sure, ny will cut 10,000 employees, shutter tories, and reshuffle management in effort to get its famously fractious di- ions to work together. But nowhere did alysts see much proof that Stringer is kling the most urgent task: reforming ny's engineering-driven culture to cre- gadgets that customers actually want. And if Stringer & Co. needed a re- nder that Sony must change fast, they it five days later. On Sept. 27, Intel rp. and Microsoft Corp. threw their pport behind a next-generation DVD mat from Toshiba called HD DVD— s delivering a blow to Sony's Blu-ray nology, widely considered technolog- ly superior. Addressing Sony's myriad llenges, Stringer told *BusinessWeek*: "It's urgent we rectify this situation."

As he looks for inspiration, Stringer might consider taking a page from Samsung Electronics Co. Yes, the two companies have vastly different portfolios, with Samsung earning most of its profits from chips and Sony owning music and movie studios. And it's true that Samsung remade itself only after a near-death experience, following the Asian financial crisis in the late '90s. Still, the Korean company has taken many of the steps that analysts believe Sony needs to take, ranging from collaborating more with partners to doing a better job taking its cues from the market. In doing so, it has become one of the nimblest players in the business. "When Samsung wants to get something done," says Intel Executive Vice-President Sean M. Maloney, "the decision comes down from the top, and everybody moves at lightning-quick speed to just do it."

Sour and Sweet

	2005 OPERATING PROFITS*	2005 SALES*
SONY'S ELECTRONICS DIVISION **	–$1.2 Billion	$44.6 Billion
SAMSUNG ELECTRONICS	$8.1 Billion	$57 Billion

*Estimated **Fiscal year ending March 31, 2006
Data: Sony; JPMorgan Securities Asia; Samsung Electronics; Hyundai Securities

CAMERA-PHONE PIONEER

WHAT SAMSUNG HAS done isn't rocket science—more like Business 101. For example, the company routinely dispatches designers and engineers to labs in New Jersey, Seoul, and other places to gauge consumers' tastes for new products. Thanks to such research, Samsung was one of the first to pack digital cameras and music players into cell phones, creating instant hits.

Doesn't Sony do similar studies? Of course. Yet, with its gearhead culture, Sony continues to act like the great brand of yore, believing it can dream up products behind closed doors and unleash them on a grateful market at premium prices. This helps explain why Sony stuck with its Trinitron televisions long after flat-panel TVs had won the day. Moreover, Sony has a bias toward its home market. That's why its gadgets often feature complex software that Japanese love but that drives Americans crazy.

SONY SUPERSTORE CEO Stringer will streamline and centralize the company

Samsung's top managers also come down hard on their units to make sure they're working together to come up with new products. Again, sounds pretty basic— but over at Sony, factionalism still rules the day. The company's music, movie, and gadget businesses have conflicting agendas and often balk at cooperating. In one famous example, Sony's music division, fearing piracy, kept the consumer electronics side from making digital-music players that would let consumers play the popular MP3 format. Hello iPod; goodbye Walkman.

The last thing Sony can afford to do is

miss out on the emerging portable video-player market. Yet once again, Sony's content guys are making sure that consumers can play only pricey Sony-formatted disks on its PlayStation Portable. To win in this business, say analysts, Stringer will have to overcome the qualms of the content side and open Sony's players to other formats.

BIRTH OF THE NANO

ANOTHER KNOCK against Sony: It doesn't play well with other industry titans. Samsung has no such qualms. Last February, chip chief Hwang Chang Gyu went to see Steven P. Jobs to try to get him to use the company's flash memory chips in Apple's music players. Jobs wasn't interested at first, but Hwang kept pressing him and eventually Jobs saw the potential. Bingo: The iPod nano was born, and Samsung won a big order for flash chips. How could Sony mimic this approach? By licensing designs or technology, such as its cell chip, to others.

Only a cultural upheaval can make Sony nimbler

Matching Samsung's nimbleness will require a cultural revolution inside Sony. That won't be easy. Samsung's flirtation with collapse let CEO Yun Jong Yung crack the whip. But insiders say there is no sense of real crisis at Sony, although Stringer has made some moves. On Sept. 14 he named Andrew House, who ran marketing for Sony's PlayStation unit, to oversee global branding. That could help tie the content and hardware properties together by offering free hit movies and music with purchases of everything from PCs to cellular phones. "Nearly every device will come with content," Stringer says. And in a symbolic gesture, he operates from the sixth floor at Tokyo headquarters, where Sony's strategic planners reside, instead of the eighth floor digs of past CEOs.

A little more than three months into the job, Stringer says he has a clear understanding of what ails Sony. Now the market is looking for the kind of tough love that turned Samsung into a formidable competitor. ■

–By Cliff Edwards in San Mateo, Calif., with Tom Lowry in New York, Moon Ihlwan in Seoul, and Kenji Hall in Tokyo

ENERGY

SAUDI ARABIA: A WHOLE NEW DRILL

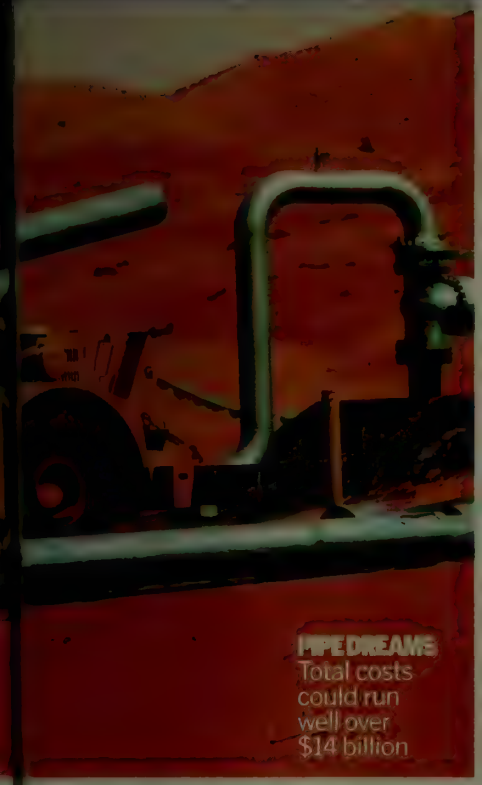
Anticipating a rise in long-term demand, the kingdom is ramping up production

SAUDI ARABIA'S IMAGE AS master of the oil patch has been taking a beating of late. For months global markets have fretted that the Saudis can't or won't produce enough oil to keep a lid on soaring prices. Politicians around the world are blasting the kingdom for failing to open the taps more. And Houston investment banker Matthew R. Simmons has captured headlines with his book *Twilight in the Desert*, which says that Saudi production may be peaking and an oil shock bigger than the current one is on the way.

Yet, little noticed by the outside world, the Saudis are making some bold moves. In recent months, Saudi Aramco, the national oil company, has been rapidly inking deals with drilling rig operators and oil field contractors. Some 70 drilling rigs are now operating in the kingdom, up from 55 in 2004 and about 20 in th mid-1990s. By next year Aramco aims t have 110 rigs drilling, although that ma be unreachable because of fierce compe tition for equipment.

It's all part of a massive effort to ad some 3 million barrels per day of pro duction capacity—comparable to a larg producer such as Kuwait or Venezuel That would be a more than 30% lea over the roughly 9.5 million bbl. per da Saudi Arabia is now producing, a though in a pinch it claims that it cou get output up to 11 million bbl. The co of hundreds of new wells and related in frastructure could exceed $14 billion. spokesman for Saudi Aramco says th national oil company is even looking "scenarios to bolster [production] even 15 million barrels per day" if d mand warrants.

If the Saudis succeed, the tightne that has plagued the world's oil marke



PIPE DREAMS Total costs could run well over $14 billion

ay ease for the medium term, relieving ices. New Saudi oil would join increas- from West Africa, Brazil, Central Asia, d the Gulf of Mexico. "This is very im- rtant," says Jamal Qureshi, an analyst consultants PFC Energy in Washing- n. Saudi production combined with the hers could lead to "a pretty good supply lge" over the next few years, he says. it unlike a non-OPEC country such as ssia, which is likely to produce close to t out, the Saudis may dial back on both oduction and expansion plans if they nk a glut is developing.

What has kicked the Saudis into gear? e surge in demand from the U.S., Chi- , and elsewhere seems to have con- ced them that it is worth pouring ney into expanding production. The udis also want to regain lost clout in e market. While they aren't sorry to be ning $145 billion or so from oil this r, the Saudis don't like their lack of wer over prices. The only way to regain it is by having barrels to add or subtract from the market. "They want to maintain a certain spare capacity cushion. The price runups we saw in the last few years have spooked them, too," notes Qureshi.

The Saudis are also well aware that the spare capacity they do have is the wrong stuff. Their clients want light crude, best suited for converting into gasoline. The heavy crude that forms most Saudi spare capacity sells at a discount, if at all. Much of the new oil will come from expansion of fields such as Qatif and Khursaniya that were mothballed in the 1980s, when production fell and the Saudis decided not to juice it up again. They'll also make big additions to the newer Shaybah field, which produces some 500,000 bbl. per day of light crude from below the red sand dunes of the Empty Quarter.

VYING FOR RIGS

OF COURSE A MASSIVE expansion of oil production won't be easy for the Saudis, who have coasted, with a few exceptions, for 20-plus years. Aramco engineers are proud of the job they did in the 1990s developing Shaybah, which was brought onstream ahead of schedule and uses high-tech multi-branched wells. But their new undertakings are on a far grander scale. They will need to manage large numbers of foreign contractors on several different sites—no easy task. They will also need to pay top dollar in an overheated market.

The Saudis are already vying for a limited number of rigs. Aramco will be paying Houston-based Rowan Cos. $100,000 to $105,000 per day for each of four large offshore rigs slated to begin exploring for oil and reworking wells in the Arabian Gulf for a three-year period beginning in early 2006. The Saudis originally contracted for five Rowan rigs but one is missing following Hurricane Rita. Rowan hasn't found work in the kingdom since 1981. "It's a nice way to go back," says William C. Provine, an investor relations vice-president. Another participant is Bermuda's Nabors Industries Ltd., which has 10 rigs in the kingdom.

The Saudis also face technical challenges. Oil projects are complex and expensive. It is not just a question of drilling. Massive infrastructure needs to be built for separating the oil from the gas, for injecting water into the fields to maintain pressure, and for piping the oil to refineries. According to one industry source in the region, the Khurays field, the largest expansion planned, will need an estimated 400 wells drilled to produce the target of 1.2 million bbl. If each rig drills six to seven wells per year, that would require some 20 rigs at the site for three years. The field will also need 2 million bbl. per day of water injection, facilities to process the water, and pipelines.

Given all that, getting production up even to 12.5 million bbl. per day seems a tall order, especially considering the Saudis need to add enough capacity to offset declines of 400,000 to 500,000 bbl. per year in existing fields. "Clearly Aramco has allocated the funds and set up the contracts for the expansion. The challenge will be for the contractors to mobilize the materials, drilling equipment, and human resources to meet the kingdom's very tight schedules," says Sadad Husseini, a former Aramco executive vice-president for exploration and production.

Then there is the question of whether the Saudis have the oil. As Simmons points out in *Twilight in the Desert*, the Saudis have few alternatives but to look for gains from fields that had serious problems in the past. But analysts such as Qureshi, who closely watch the kingdom, think the Saudis will at least come close to meeting their goals—as long as world demand holds up. If the Saudis see demand leveling off, they will likely delay. So the key to future markets and to how fast the Saudis add production is how fast demand grows—something no one has proved very good at forecasting so far. ■

–By Stanley Reed in London

Saudis Go For the Black Gold

For years the Saudis have done ittle to expand production. Now hey aim to boost capacity 30% ver current output.

FIELD	NEW CAPACITY (BARRELS/DAY)	COST ($ BILLIONS)	EXPECTED COMPLETION
SAFAH, QATIF	650,000	4	2004*
HARADH	300,000	1	2006
KHURSANIYA	500,000	3	2007
SHAYBAH, NUAYYIM	300,000	3	2008
KHURAYS	1.2 million	5	2009

*In operation **Data:** Saudi Aramco, Samba, Saudi National Security Assessment Project

TAKEOVER

A RUN ON DETROIT'S PARTS MAKERS

Big money is chasing the thousands of outfits that supply U.S. carmakers

TESTING ROOM Collins & Aikman may be merged with other makers

IT'S HARD TO IMAGINE a less sexy business than auto parts—especially these days. The industry has nearly every problem afflicting American business: union strife, runaway health-care costs, heavy debt, overcapacity, and exposure to raging steel and fuel prices, not to mention an uncertain future amid rising competition from Asia and Eastern Europe.

And yet plenty of big money is chasing parts makers these days. From a passel of private equity buyers, including New York investor Wilbur Ross, to a handful of foreign parts makers, investors are trolling for deals among America's ailing auto suppliers. They've got plenty to choose from: Just since the start of 2004, 35 parts makers have filed for bankruptcy protection. Chunks of Delphi Corp. and Visteon Corp.—respectively the No. 1 and No. 2 industry players—could soon be on the block. And dozens of small, still-healthy outfits are ready to sell out as big customers such as Ford Motor Co. and General Motors Corp. insist that more parts be manufactured in low-cost Asia. "Literally every day, some company comes up for sale," says Thomas T. Stallkamp, former Chrysler Group president and now a managing partner with New York private equity firm Ripplewood Holdings LLC.

The combination of eager buyers and frantic sellers is sparking a wave of consolidation that's expected to rapidly transform the parts business during the next several years. Some buyers are looking to snap up bankrupt companies so they can restructure the finances, fix u the underlying assets, and sell them for profit. Others are aiming to roll up th smaller mom-and-pop shops into large conglomerates that can compete globall Some lesser-known European and Asia players are also trying to get a toehold i North America.

GLOBAL PRESENCE

THE UPSHOT: In a few years, many of to day's 10,000 parts makers may be gon Those that survive will collectively hav fewer plants—and should be running lot closer to full tilt. More production wi move overseas. Eventually, say analys and investors, the industry will start mal ing serious money. "Half of the supplie names will not be around in five years says Craig Fitzgerald, a partner at mar agement consulting firm Plante & Mora "The remaining companies will be bigge better capitalized, and healthier."

No one is poised to spur—or bene from—this shift more than Wilbur Ros The 67-year-old investor, who rolled se eral failed steelmakers into the now-pro itable International Steel Group Inc., ha already doled out some of his $4.5 billio war chest to assemble a diverse portfol of parts interests. He just bought a stal in Oxford Automotive Inc., whic emerged from bankruptcy in April, an control of Safety Components Intern tional Inc.

His biggest play with auto interi company Collins Aikman Corp., whic filed for Chapter 11 May 17. Ross and other investors boug just over half of its $750 million in bar debt. Depending on how the reorganiz tion is structured, that should give them decent equity position once Collins & Ai man emerges from bankruptcy. Ross al is bidding on the company's assets. Eve tually, he may take some of the plants an roll them up with other companies in sin ilar businesses. His plan: to create one more makers with a global presence and broader customer base. "That way," says, "you aren't vulnerable to changes [customers'] market share."

Bankrupt companies aren't the on

Dismal Numbers

The auto-parts industry has plenty of room for improvement

81%	3:1	35
AVERAGE USE OF PRODUCTION CAPACITY; STRONG PROFITS REQUIRE 90%	DEBT-TO-EQUITY RATIO OF THE AVERAGE PARTS MAKER, UP FROM 2:1 IN 2000	BANKRUPTCIES FILED SINCE JANUARY 2004, VS. JUST ONE IN 2003

Data: Fe... Morgan, Alex Partners, W.L. Ross & Co.

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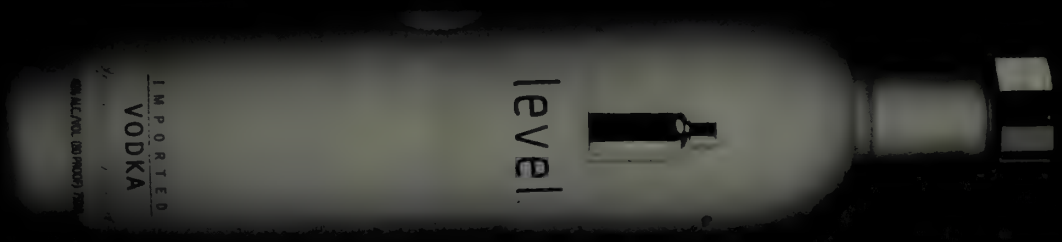

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targets. The vast majority of the industry's parts makers are independent players with less than $170 million in annual revenue. Many are family businesses that, while profitable, see the writing on the wall. Not only are their main customers reeling amid a fiercely competitive auto market but parts makers themselves are also increasingly being undercut by Asian rivals. Indeed, last year Chinese auto suppliers sent an estimated $3 billion worth of auto parts to the U.S., nearly triple the level of 2001.

BOLTED TOGETHER

SO WHAT DO ACQUIRERS see in these smaller companies? In some cases, diversifying their customer base is the goal. Private equity investor Carlyle Group in Washington, D.C., which has deep roots in the defense industry, recently snapped up AxleTech International in Troy, Mich. Carlyle figures there's plenty of growth to be had expanding AxleTech's defense business by making more parts for tactical military vehicles.

In other cases, acquirers are simply bolting the small players together to gain global heft. Ripplewood, which has already acquired three aluminum casting companies outside the U.S., is looking for similar acquisitions in North America and elsewhere. Such companies, even healthy ones, lack sufficient cash to expand overseas. The idea, says Stallkamp, is to hitch a bunch of them together and build a giant global supplier with factories around the world that would provide many parts, including engine blocks, transmissions, and suspension parts to a range of auto makers.

Foreign players see a good time to buy cheap, too. European suppliers such as France's Faurecia and Spain's Gestamp are looking for deals. Companies from China and India also want a piece of the action. In June, Bharat Forge Ltd. of India bought bankrupt Federal Forge Inc. near Lansing, Mich. Other are sure to follow. "We have seen plenty of deals from Europe, and we expect more from Asia," says Jim Gillette, director of supplier analysis for research firm CSM Worldwide in Northville, Mich.

Things are about to get very Darwinian in the auto-parts industry—and given the pricing pressures, overcapacity, and weak profits, that's exactly what it needs. ■

–By David Welch in Detroit and Nanette Byrnes in New York

PLAINTIFFS The Hendersons were left with $158,000 in medical bills

INSURANCE

LAWSUITS, STATE PROBES—LET'S BUY IT!

Big health insurers have acquired small players with pledges to fix what's broke

THE IDEA WAS TO RELAX. After 40 years in publishing, David and Darlene Henderson retired nine years ago to Penn Valley, Calif., a sleepy town 60 miles north of Sacramento. The couple signed up for health insurance through the National Association for the Self-Employed (NASE), a small-business group that offered them both coverage through MEGA Life & Health Insurance Co. for $416 per month. A brochure stated that the plan would provide up to $1 million in coverage.

Then in 2000, Darlene found a lump in her breast and had a mastectomy. The next year, David had emergency surgery for an aortic aneurysm, followed by three colon procedures. By April, 2001, their medical bills totaled more than $210,000. But for David and Darlene, both 66, the troubles were just beginning. MEGA refused to cover Darlene's bills because, the company alleged, her breast cancer resulted from a preexisting condition she had failed to disclose. The Henderson say they held back no such informatio And MEGA's benefits, which the Hende sons allege were poorly explained, co ered only $33,169 of David's $191,424 bills. "You think you're on a sunny sea says David. "Then you're sucked into th Bermuda Triangle." The couple has filed lawsuit against NASE and MEGA's pare company, UICI, based in North Richlan Hills, Tex., charging fraud and unfa business practices. The company deni those allegations.

The Hendersons aren't alone. Thr major players in the individual insuran market, including UICI, have racked u an inordinate number of complaints f their size. In addition to UICI, Golde Rule Insurance and American Medical S curity have been hit with a barrage state investigations. In fact, since 199 MEGA and the other main unit of UIC Mid-West National Life Insurance C have been the subject of 14 investigatio by state insurance officials, according data provided by the National Associati

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of Insurance Commissioners (NAIC).

The investigations, though, haven't fazed investors, including Blackstone Group, which on Sept. 15 bought UICI for $1.7 billion. With their often hefty margins and growing profits, smaller companies that offer individual insurance are in demand. The Blackstone deal follows the purchase last December of American Medical Security by PacifiCare Health Systems in Cypress, Calif., and UnitedHealth Group's deal for Golden Rule in 2003. The new parents are making progress cleaning up these companies, but some question whether they will finish the job. Warns California Insurance Commissioner John Garamendi: "They damn well better."

SOME STRIDES

ONE BIG REASON to get back in regulators' good graces: The individual health insurance market is poised to boom. With 45 million people uninsured and penny-pinching companies cutting back, more Americans are being forced to get their own protection. The number of people buying health insurance on their own jumped by 900,000, to 17 million from 2000 to 2003—the latest year for which data are available—according to Mathematica Policy Research Inc. Meanwhile, employment-based coverage fell by 5.2 million, to 159.2 million.

Soaring demand is one reason why UnitedHealth paid $500 million in 2003 for Golden Rule, of Lawrenceville, Ill., problems and all. Since 1995, Golden Rule has faced 15 investigations by insurance officials for aggressive sales tactics and questionable marketing. That compares with just nine investigations at UnitedHealth, though Golden Rule's revenues barely equaled 3% of UnitedHealth's 2003 revenues. At its low point, in 2002, Golden Rule settled for $660,000 a nine-state investigation that found its small-group policies required employees to submit "proof of good health," a violation of federal health-care rules. In addition to the payment, Golden Rule agreed to make "substantive" changes in the way it does business in those states.

Since taking over Golden Rule, UnitedHealth has made further strides. Complaints against the outfit have dropped by more than half. And as UnitedHealth expands Golden Rule, it is encouraging consumers to check health-care costs via its online "treatment cost estimator" so they aren't surprised by big out-of-pocket bills. "When we

acquire a company, we take responsibility for all their past conduct," says Mark F. Lindsay, UnitedHealth's vice-president for communications and strategy.

American Medical Security has been in a similar spotlight. The Green Bay (Wis.) insurer clashed with Florida regulators in 2002 when it hiked premiums for policyholders who got sick. That sparked a nationwide review of such practices. Still, last December, California insurer PacifiCare acquired AMS for $505 million. A PacifiCare executive says the company has moved quickly to package AMS' low-end health plans with the more comprehensive coverage that it already offered.

Blackstone may have a tougher job cleaning up UICI. There are still many unhappy customers such as the Hendersons, whose lawsuit against UICI Inc. is ongo ing. The company says it will fight the cas In a written response, Chief Executiv William J. Gedwed says: "At the time o application, Mr. and Mrs. Henderso withheld material information concernin Mrs. Henderson's pre-application healt history." As a result, the company believe it had the right to terminate both Hende sons' coverage, though it chose to cut onl Darlene's. Moreover, Gedwed says Davi Henderson has received $90,000 in ben fits from UICI—not the $33,000 he claim to have been paid. The difference, says th Hendersons' attorney Anthony Stuart, that UICI adds in discounts it receives as member of a hospit network. A trial scheduled to begin i California Superi Court in January.

CALIFORNIA Garamendi held hearings into "illusory" health policies

The company als faces a multi-state i vestigation launched in May by Washin ton and Alaska regulators. Moreover, a cording to the NAIC, complaints at MEGA unit were more than double the n tional average, albeit down from fo times higher than average in 2003. UICI Gedwed disputes the NAIC's complain rate calculations because, he says, they u fairly penalize companies with large nu bers of individual policyholders, who u state regulators instead of corporate H departments, to file complaints. Califor Commissioner Garamendi held hearin in San Francisco on Sept. 21 into so-call "illusory" insurance policies that offer li ited benefits that barely cover medic costs. UICI points out that it paid $1.4 b lion in medical claims last year.

Dogged by such criticism, UICI hir PricewaterhouseCoopers L this year to help it through t multi-state investigation. Gedw says UICI has also implemented system of follow-up calls to ensu that new customers fully unde stand their benefits.

Blackstone is trying to furth mend fences. Three weeks ago e ecs met with Washington Sta Commissioner Mike Kreidler, w heads the multi-state investig tion. While the company won't d close specifics, it says it is planni to improve UICI's customer servi and regulatory compliance. Tha little comfort to the Henderso and others like them who cla they've been shortchanged and to fend for themselves. ■

–By Brian Grow in Atlan with Joseph Weber in Chica

Seeing Green

Growth prospects—and soaring profits—have major players snapping up small providers of individual health insurance

	MEGA LIFE (acquired by Blackstone Group)	GOLDEN RULE (acquired by UnitedHealth)
	PRETAX PROFITS, IN MILLIONS	
2002	$35.6	$61.1
2003	39.8	82.3
2004	125.5	155.7

Data: Standard & Poor's

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5,000 trucks.
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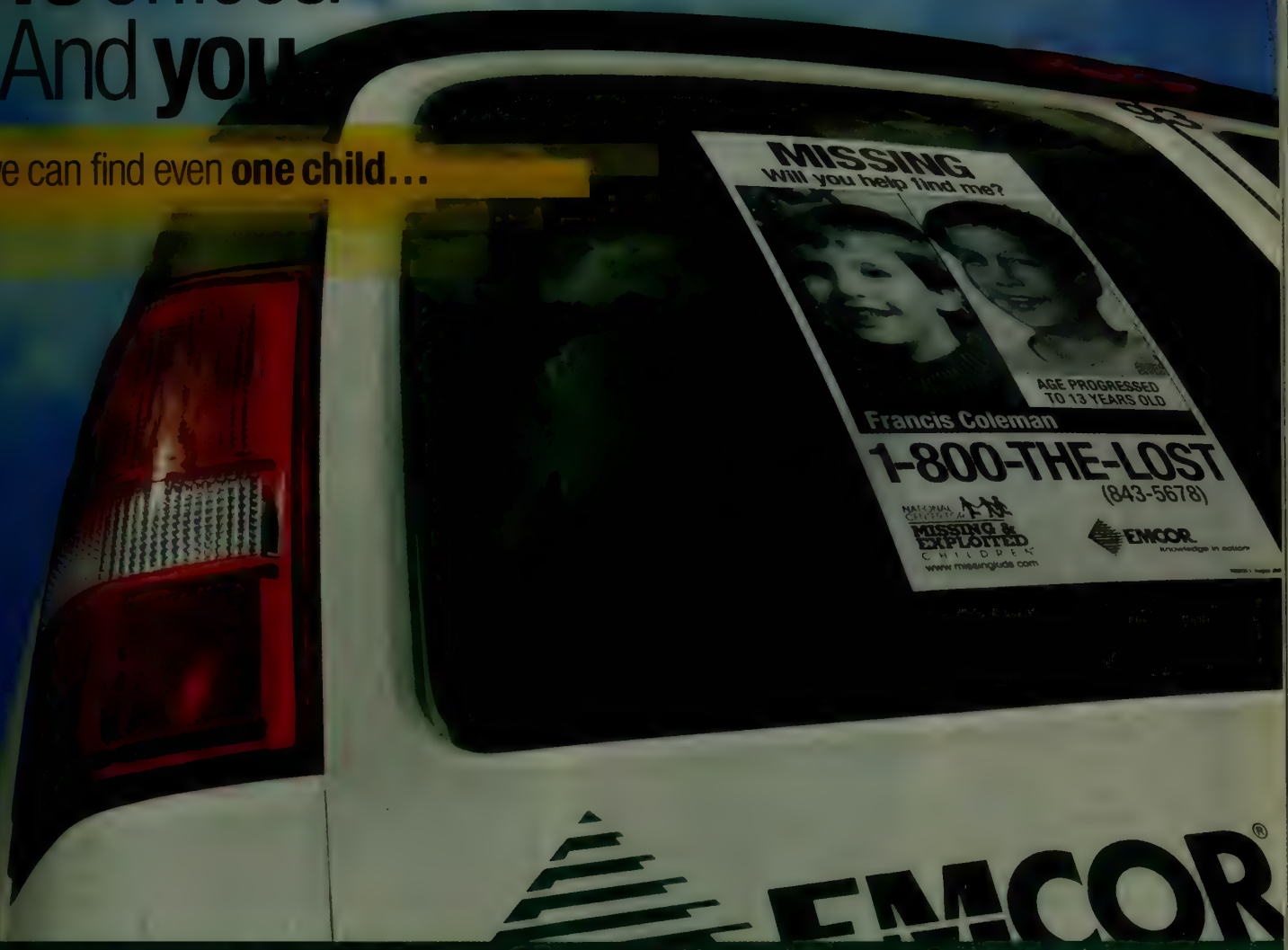

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COMMENTARY

BY HARDY GREEN

Why Oprah Opens Readers' Wallets

She offers the guidance and sense of community bookstores no longer provide

HOW DOES OPRAH WINFREY do it? And why does no one else—TV pundit, critic, or retailer—have anything like her influence among book readers? ¶ On Sept. 22, Winfrey announced that the next pick for her television book club would be James Frey's *A Million Little Pieces*, a memoir of alcohol, drug addiction, and detoxification. Within four days, club aficionados bought 85,000 copies, reckons publisher Anchor Books. An additional 615,000 books bearing the Oprah's Book Club seal await purchasers at stores.

Winfrey's actions have inspired so many book-buying frenzies that we are no longer fazed. She has repeatedly proved herself to be the arbiter of literary taste for millions of Americans, turning classics such as John Steinbeck's *East of Eden* into overnight million-sellers and making sensations out of lesser-known works such as Mary McGarry Morris' *Songs in Ordinary Time*.

Perhaps the most astonishing aspect of the Oprah phenomenon is how outsized her power is compared with that of other market movers. Some observers suggest that Jon Stewart of Comedy Central's *The Daily Show* could be No. 2. Other proven arm-twisters include Fox News's Sean Hannity, National Public Radio's Terry Gross, radio personality Don Imus, and CBS' *60 Minutes*. But no one comes close to Oprah's clout: Publishers estimate that her power to sell a book is anywhere from 20 to 100 times that of any other media personality.

Reviews can sell books, too, but they tend to be more nuanced than the broadcast media. *The New York Times Book Review* is generally believed to contain the most influential criticism—there "even a bad review can sell 6,000 books," says Russell Perreault, Anchor Books publicity director. But HarperSanFrancisco Associate Publisher Claudia Riemer Boutote is quick to add that, no matter what the publication, a rave review that truly boosts sales is "few and far between." What publishers want is what Oprah invariably delivers: unconditional praise. Oprah loves to say: "Read this book!"

It all boils down to the difficulty many people have in discovering a new read. Sure, many readers find searching at online-bookseller sites, trolling the aisles at superstores, or getting recommendations from book-loving clerks at the waning number of old-fashioned independent stores to be wonderful. Yet Oprah's huge following proves that these approaches simply don't work for legions of others.

When many readers want to delve into something weightier than the latest John Grisham or Danielle Steel, they're stumped. A flood of advice is available from critics, bloggers, podcasters, and pundits. A big bookstore only adds to the confusion, with its profusion of volumes bearing blurbs from esteemed publications and brand-name cultural commissars.

Adding to the difficulty is the decline in the number of store personnel able to make worthwhile recommendations. Moreover, it's no secret that the most prominently displayed books—piled near the front door or turned face-out on a shelf—often score their exposure as a result of payments from publishers, not because of store managers' enthusiasm. Even if bookstore patrons aren't aware of this merchandising stratagem, they may sense the absence of the personal touch.

In the end, the browser may figure, I'll just try one—a gamble that may cost (gulp) $30. Buyer's regret often ensues. Then the same reader happens to try an Oprah-endorsed book. Bingo: That was pretty good. Chalk up another book-club believer.

So Winfrey provides what's missing in stores and online. She also creates communities of readers, ensuring that no one needs face brain benders like William Faulkner's *The Sound and the Fury* all alone. The books often contain "something so amazing you can't wait to share it," says Rachel Bensadia of New York City, whose book club reads Winfrey's picks. "Reading is a solitary experience, but it can also be very much about creating a community." No one has been able to singlehandedly connect readers and sell books quite like Oprah has. ■

Oprah's book-selling clout is 20 to 100 times that of any other arbiter of culture

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Capital Appreciation Fund	**10.72%**	**13.64%**	**12.68%**	**0.83%**
Lipper Multi-Cap Value Funds Average	10.72%	6.22%	10.14%	1.59%
Dividend Growth Fund	**7.85%**	**3.20%**	**9.74%**	**0.78%**
Lipper Multi-Cap Core Funds Average	7.16%	-0.36%	9.37%	1.48%
Spectrum Growth Fund	**10.72%**	**2.01%**	**9.76%**	**0.86%**
Lipper Multi-Cap Core Funds Average	7.16%	-0.36%	9.37%	1.48%

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EDITED BY MONICA GAGNIER

HEADLINER

LARRY GLASSCOCK

CHOOSING WELL

For WellPoint CEO Larry Glasscock, banking and health care are a lot alike: service businesses where technology and size matter. Money counts, too. The banker-turned-health-care executive proved that anew on Sept. 27 with a $6.5 billion deal for WellChoice, the New York Blue Cross Blue Shield company. The deal cements WellPoint's position as the nation's largest health insurer, with 33 million customers in 14 states.

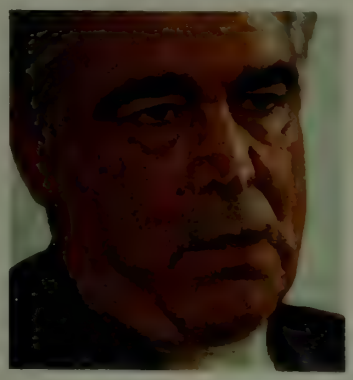
Glasscock, 57, spent 20 years at a Cleveland bank before jumping to lead a Blue Cross Blue Shield unit in Washington, D.C., in 1993. He has since earned his stripes as a dealmaker in the rapidly consolidating industry. His $16.4 billion purchase last fall of California-based WellPoint, whose name his Indianapolis company took, went smoothly, even as California regulators denounced executive payouts and won concessions. Then came a seamless $185 million purchase of Luminos, a Virginia health insurer. With further consolidation likely in health care, look for more deals ahead.

–Joseph Weber

DREAM ON, DREAMWORKS

Anyone got a billion for the movies? That's the price that **DreamWorks** wanted to sell its studio to **General Electric**'s **NBC Universal** unit. Two months of talks broke down between GE and the live-action-movie arm of DreamWorks, started in 1996 by Hollywood moguls David Geffen, Steven Spielberg, and Jeffrey Katzenberg. (The publicly traded DreamWorks Animation wasn't included in the talks.) DreamWorks, whose 60-odd-title film library includes Oscar winner *American Beauty*, had a rocky summer with films like *The Island*. But talks still could resurface with Universal, which distributes DreamWorks films overseas.

KODAK'S DIGITAL DELAY



Eastman Kodak has long warned that its transition from film to digital would be rocky. It hit another bump on Sept. 28, when the company said this year's digital operating profits would fail to meet its target of $275 million to $325 million. One reason: Because of concern the economy may be slowing, Kodak will build fewer digital cameras in the fourth quarter, the most important for camera sales. Even so, CEO Antonio Perez was upbeat about Kodak's long-term prospects during a speech to investors on Sept. 28. By 2008, he predicted, Kodak would be such a fast-growing and profitable digital company that film would be little more than "gravy."

GM DOWNSIZES UP NORTH

An 11th-hour deal averted a strike by 17,000 members of the **Canadian Auto Workers** against **General Motors**. The two sides agreed on a contract three minutes before midnight on Sept. 27. The pact allows GM to eliminate about 1,000 jobs, mostly by attrition. The contract mirrors deals the CAW reached earlier in September with **Ford Motor** and **DaimlerChrysler** on the size of job cuts and the 3.5% wage increase. The pact came despite GM's earlier assertion that big North American losses meant it wouldn't accept the same pattern as Ford and Chrysler. The carmaker will cut as many as 300 jobs at its Oshawa (Ont.) truck plant, where productivity has increased. GM still faces tough talks this fall with the United Auto Workers about reducing health-care costs, although the current U.S. labor contract lasts two more years.

BRAMBLES FOR BLACKBERRY

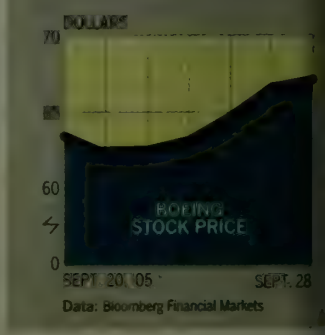
With competition heating up in the wireless e-mail space, the pressure is on **Research in Motion** and its pioneering BlackBerry mobile gizmo. In a significant blow to RIM, **Palm**, the maker of the Treo device, is teaming up with onetime rival **Microsoft**. The next version of the Treo will use Microsoft's operating system, helping the software giant in its push into the market for mobile data devices. In a twist, RIM announced it would use chips from traditional Microsoft partner **Intel** to boost its data transmission speed. RIM also reported a 57% jump in its second-quarter profit, but new subscriptions missed some analysts' estimates.

ET CETERA...

- **Tribune Co.** will appeal a federal tax ruling against it for $1 billion.
- Russia's **Gazprom** is buying oil company **Sibneft** for $13.1 billion.
- **ATA Airlines** pilots ratified a labor deal worth $84.5 million in savings.

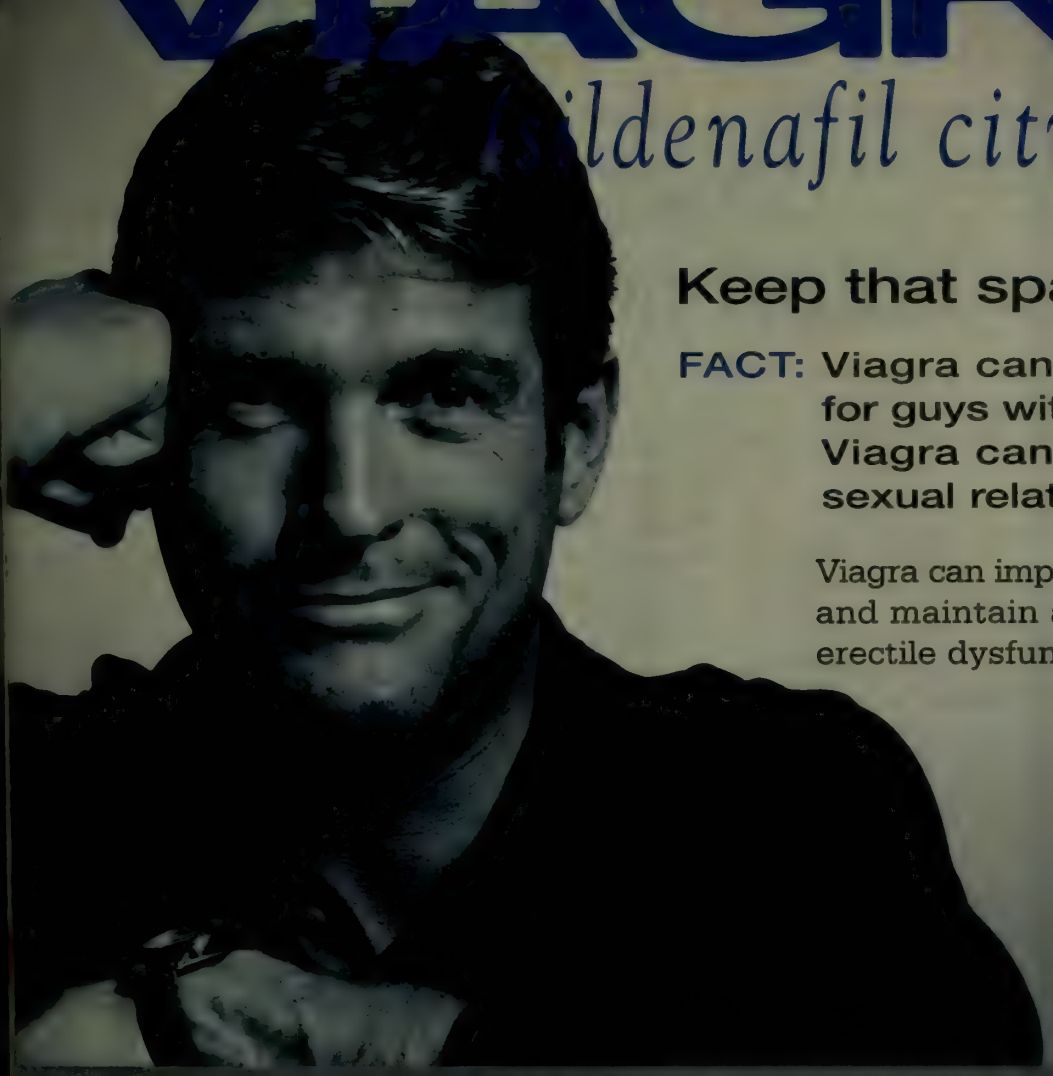
CLOSING BELL

Boeing's stock got a nice lift after the planemaker announced a tentative deal on Sept. 25 to end a 26-day strike with its 18,400 commercial airplane workers. Shares of Boeing closed at $67.21 on Sept. 28, up more than 6% since the strike was settled.



VIAGRA®

(sildenafil citrate) tablets



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FACT: Viagra can improve erections for guys with ED. Studies show Viagra can also improve their sexual relationship satisfaction.

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IAGRA is prescribed to treat erectile dysfunction. We know that no medicine is for everyone. you use nitrate drugs, often used for chest pain (known as angina), don't take VIAGRA. aking these drugs together could cause your blood pressure to drop to an unsafe level.

he most common side effects of VIAGRA are headache, facial flushing, and upset stomach. ess common are bluish or blurred vision, or being sensitive to light. These may occur for a rief time. Remember to protect yourself and your partner from sexually transmitted diseases.

alk with your doctor first. Make sure you are healthy enough to have sex. If you have chest ain, nausea, or other discomforts during sex, seek medical help right away. Although erections sting for more than four hours may occur rarely with all ED treatments in this drug class, is important to seek immediate medical attention. Erections lasting longer than six hours n result in long-term loss of potency.

IAGRA is covered under most Managed Care Plans.*

nportant Information: Viagra is one of several ED treatments that you and your doctor can consider.

ase see our patient summary of information for VIAGRA (25 mg, 50 mg, 100 mg) tablets on the following page.
rcent of members by formulary status for HMOs, PPOs and POS for Viagra, Levitra, and Cialis. *Formulary Compass*™
diMedia USA, Inc. February 2005.

Pfizer U.S. Pharmaceuticals

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PATIENT SUMMARY OF INFORMATION ABOUT VIAGRA®

(sildenafil citrate) **tablets**

This summary contains important information about VIAGRA®. It is not meant to take the place of your doctor's instructions. Read this information carefully before you start taking VIAGRA. Ask your doctor or pharmacist if you do not understand any of this information or if you want to know more about VIAGRA.

This medicine can help many men when it is used as prescribed by their doctors. However, VIAGRA is not for everyone. It is intended for use only by men who have a condition called erectile dysfunction. **VIAGRA must never be used by men who are taking medicines that contain nitrates of any kind, at any time. This includes nitroglycerin. If you take VIAGRA with any nitrate medicine your blood pressure could suddenly drop to an unsafe or life threatening level.**

• What Is VIAGRA?
VIAGRA is a pill used to treat erectile dysfunction (impotence) in men. It can help many men who have erectile dysfunction get and keep an erection when they become sexually excited (stimulated).

You will not get an erection just by taking this medicine. VIAGRA helps a man with erectile dysfunction get an erection only when he is sexually excited.

• How Sex Affects the Body
When a man is sexually excited, the penis rapidly fills with more blood than usual. The penis then expands and hardens. This is called an erection. After the man is done having sex, this extra blood flows out of the penis back into the body. The erection goes away. If an erection lasts for a long time (more than 6 hours), it can permanently damage your penis. You should call a doctor immediately if you ever have a prolonged erection that lasts more than 4 hours.

Some conditions and medicines interfere with this natural erection process. The penis cannot fill with enough blood. The man cannot have an erection. This is called erectile dysfunction if it becomes a frequent problem.

During sex, your heart works harder. Therefore sexual activity may not be advisable for people who have heart problems. Before you start any treatment for erectile dysfunction, ask your doctor if your heart is healthy enough to handle the extra strain of having sex. If you have chest pains, dizziness or nausea during sex, stop having sex and immediately tell your doctor you have had this problem.

• How VIAGRA Works
VIAGRA enables many men with erectile dysfunction to respond to sexual stimulation. When a man is sexually excited, VIAGRA helps the penis fill with enough blood to cause an erection. After sex is over, the erection goes away.

• VIAGRA Is Not for Everyone
As noted above (*How Sex Affects the Body*), ask your doctor if your heart is healthy enough for sexual activity.

If you take any medicines that contain nitrates – either regularly or as needed – you should never take VIAGRA. If you take VIAGRA with any nitrate medicine or recreational drug containing nitrates, your blood pressure could suddenly drop to an unsafe level. You could get dizzy, faint, or even have a heart attack or stroke. Nitrates are found in many prescription medicines that are used to treat angina (chest pain due to heart disease) such as:

- nitroglycerin (sprays, ointments, skin patches or pastes, and tablets that are swallowed or dissolved in the mouth)
- isosorbide mononitrate and isosorbide dinitrate (tablets that are swallowed, chewed, or dissolved in the mouth)

Nitrates are also found in recreational drugs such as amyl nitrate or nitrite ("poppers"). If you are not sure if any of your medicines contain nitrates, or if you do not understand what nitrates are, ask your doctor or pharmacist.

VIAGRA is only for patients with erectile dysfunction. VIAGRA is not for newborns, children, or women. Do not let anyone else take your VIAGRA. VIAGRA must be used only under a doctor's supervision.

• What VIAGRA Does Not Do
- VIAGRA does not cure erectile dysfunction. It is a treatment for erectile dysfunction.
- VIAGRA does not protect you or your partner from getting sexually transmitted diseases, including HIV — the virus that causes AIDS.
- VIAGRA is not a hormone or an aphrodisiac.

• What To Tell Your Doctor Before You Begin VIAGRA
Only your doctor can decide if VIAGRA is right for you. VIAGRA can cause mild, temporary lowering of your blood pressure. You will need to have a thorough medical exam to diagnose your erectile dysfunction and to find out if you can safely take VIAGRA alone or with your other medicines. Your doctor should determine if your heart is healthy enough to handle the extra strain of having sex.

Be sure to tell your doctor if you:

- have ever had any heart problems (e.g., angina, chest pain, heart failure, irregular heart beats, heart attack or narrowing of the heart valve)
- have ever had a stroke
- have low or high blood pressure
- have [illegible] vision loss
- have [illegible] a disease called retinitis pigmentosa
- have ever had [illegible] problems
- have ever had [illegible] problems
- have ever had [illegible] problems, including sickle cell anemia or leukemia
- are allergic to sildenafil or any of the other ingredients of VIAGRA tablets
- have a deformed penis, Peyronie's disease, or ever had an erection that lasted more than 4 hours
- have stomach ulcers or any types of bleeding problems
- are taking any other medicines

• VIAGRA and Other Medicines
Some medicines can change the way VIAGRA works. Tell your doctor about **any medicines** you are taking. Do not start or stop taking any medicines before checking with your doctor or pharmacist. This includes prescription and nonprescription medicines or remedies:

- Remember, VIAGRA should never be used with medicines that contain nitrates (see *VIAGRA Is Not for Everyone*).
- If you are taking alpha-blocker therapy for the treatment of high blood pressure or prostate problems, you should not take a dose of greater than 25 mg of VIAGRA at the same time (within 4 hours) as you take your dose of alpha-blocker.
- If you are taking a protease inhibitor, your dose may be adjusted (please see *Finding the Right Dose for You*).
- VIAGRA should not be used with any other medical treatments that cause erections. These treatments include pills, medicines that are injected or inserted into the penis, implants or vacuum pumps.

• Finding the Right Dose for You
VIAGRA comes in different doses (25 mg, 50 mg and 100 mg). If you do not get the results you expect, talk with your doctor. You and your doctor can determine the dose that works best for you.

- Do not take more VIAGRA than your doctor prescribes.
- If you think you need a larger dose of VIAGRA, check with your doctor.
- VIAGRA should not be taken more than once a day.

If you are older than age 65, or have serious liver or kidney problems, your doctor may start you at the lowest dose (25 mg) of VIAGRA. If you are taking protease inhibitors, such as for the treatment of HIV, your doctor may recommend a 25 mg dose and may limit you to a maximum single dose of 25 mg of VIAGRA in a 48 hour period. If you are taking alpha-blocker therapy, you should not take a dose of greater than 25 mg of VIAGRA at the same time (within 4 hours) as your dose of alpha-blocker.

• How To Take VIAGRA
Take VIAGRA about one hour before you plan to have sex. Beginning in about 30 minutes and for up to 4 hours, VIAGRA can help you get an erection if you are sexually excited. If you take VIAGRA after a high-fat meal (such as a cheeseburger and french fries), the medicine may take a little longer to start working. VIAGRA can help you get an erection when you are sexually excited. You will not get an erection just by taking the pill.

• Possible Side Effects
Like all medicines, VIAGRA can cause some side effects. These effects are usually mild to moderate and usually don't last longer than a few hours. Some of these side effects are more likely to occur with higher doses. The most common side effects of VIAGRA are headache, flushing of the face, and upset stomach. Less common side effects that may occur are temporary changes in color vision (such as trouble telling the difference between blue and green objects or having a blue color tinge to them), eyes being more sensitive to light, or blurred vision.

In rare instances, men taking PDE5 inhibitors (oral erectile dysfunction medicines, including VIAGRA) reported a sudden decrease or loss of vision in one or both eyes. It is not possible to determine whether these events are related directly to these medicines, to other factors such as high blood pressure or diabetes, or to a combination of these. If you experience sudden decrease or loss of vision, stop taking PDE5 inhibitors, including VIAGRA, and call a doctor right away.

In rare instances, men have reported an erection that lasts many hours. You should call a doctor immediately if you ever have an erection that lasts more than 4 hours. If not treated right away, permanent damage to your penis could occur (see *How Sex Affects the Body*).

Heart attack, stroke, irregular heart beats, and death have been reported rarely in men taking VIAGRA. Most, but not all, of these men had heart problems before taking this medicine. It is not possible to determine whether these events were directly related to VIAGRA.

VIAGRA may cause other side effects besides those listed on this sheet. If you want more information or develop any side effects or symptoms you are concerned about, call your doctor.

• Accidental Overdose
In case of accidental overdose, call your doctor right away.

• Storing VIAGRA
Keep VIAGRA out of the reach of children. Keep VIAGRA in its original container. Store at 25°C (77°F); excursions permitted to 15-30°C (59-86°F) [see USP Controlled Room Temperature].

• For More Information on VIAGRA
VIAGRA is a prescription medicine used to treat erectile dysfunction. Only your doctor can decide if it is right for you. This sheet is only a summary. If you have any questions or want more information about VIAGRA, talk with your doctor or pharmacist, visit www.viagra.com, or call 1-888-4VIAGRA.

Pfizer **U.S. Pharmaceuticals**

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July 2005

EDITED BY MIKE McNAMEE

Wall Street Pushes To Relax Pension Rules

OBBYING ISN'T ALL GRILLED RIBEYES and Grey Goose martinis. On ept. 22 a dozen Wall Street lobbyists jammed into La Loma, a oisy Mexican joint on Capitol Hill, to break tacos with eight enate staffers. The dry topic, pension-plan regs, was no match or the spicy cuisine. But the high stakes—the rules for running 4.5 trillion in pension assets managed by e financial-services industry—more than ade up for such humble surroundings.

What the Wall Streeters want: looser fi- ciary rules and easier conflict-of-inter- t limits in pension law. Securities firms ve long been eager to run pension mon- with fewer controls by the Employee etirement Income Security Act. Now ey're leaping on pension reform—a ust-pass bill propelled by the latest air- e bankruptcies—to win some relief. The ely result: more pension investments in dge funds and less protection for work- s and retirees. "This is about Wall reet wanting to attract more money thout regulatory con- aints," says Damon A. vers, associate general unsel of the AFL-CIO.

Securities industry lobby- s claim the changes they nt won't hurt pension ns. Instead, they say, w rules would actually ve money for employers d pensioners. New York nator Chuck Schumer, a mocrat with strong sup- rt on Wall Street, is push- to add the financiers' sh list to a pension bill Senate is likely to ap- ve in early October. me items on the list are already in pen- n-reform legislation awaiting final use approval.

The Street's biggest potential win: a asure that would let many hedge fund nagers avoid ERISA's fiduciary duties. w, if more than 25% of a hedge fund's ets come from pensions, the manager is uired to put workers' interests first, in- t prudently, and track assets diligently. dge funds want the rule revised so that strict standards wouldn't kick in until pension assets totaled 50%. "Pension plans increasingly are turning to alternative investments, but many hedge funds don't want to take the money because they fear the regulation," says Scott Parsons, executive vice-president of the Managed Funds Assn., a hedge fund trade group.

SCHUMER The Senate could approve new regs in October

Serving two masters?

EQUALLY CONTENTIOUS is a proposal to let managers swap stocks or other assets between a pension fund and another client without seeking bids on open markets. Such cross-trades, now banned, would cut pensions' costs and create more investment opportunities, argues Elizabeth Varley, vice-president of the Securities Industry Assn.

Pension experts, however, see trouble. Cross-trades could let investment managers arrange swaps that favor one client over another. "A fiduciary can't serve two masters," says Deene Goodlaw, an instructor at the University of California at Berkeley's Law School. And easing fiduciary rules could let hedge funds woo small and midsize pension plans, whose trustees are often less sophisticated.

Despite Wall Street's promises of savings, employers are privately uneasy about such wholesale relaxation of ERISA rules. "My guys worry about the potential for abuse," says one corporate lobbyist. That won't deter the securities folks. With Wall Street bankrolling congressional candidates to the tune of $50 million in 2004, the industry has plenty of clout on Capitol Hill—even when it's serving tacos instead of steaks. ■

–By Amy Borrus

CAPITAL WRAPUP

MORE SCRUTINY FOR FOREIGN BIDS

A MAJOR BATTLE over foreign investment in the U.S. is heating up. Spurred by the Chinese bid for oil giant Unocal, the Senate Banking Committee will lay out the case for putting more teeth into reviews of such deals at a hearing set for Oct. 6. A Government Account-ability Office report issued on Sept. 28 concludes that the interagency panel examining foreign bids should broaden its definition of the national security threats that could prompt the President to nix a transaction. A broad business coalition is preparing to protest any changes, saying new rules could crimp acquisitions here and lead to retaliation against U.S. investments overseas.

NOT SO MANY WHITE-COLLAR CROOKS?

FEDERAL criminal prosecutions have soared 31% since President Bush took office—but despite all the business scandals, the growth isn't coming from corporate crime. A Syracuse University study released on Sept. 28 finds federal white-collar cases were flat between 2000 and 2003 and have declined about 10% since then.

REGIME CHANGE BEGINS AT EMBASSIES

THE BUSH administration wants to overhaul the Foreign Service to make it as involved in regime change as soldiers in tanks. **Philip Zelikow,** counselor to Secretary of State **Condoleezza Rice,** says embassy aides should be more aggressive in pushing reform. He wants diplomats to work with dissidents and nongovernment groups. What if host governments balk? "We don't send diplomats to break the law," Zelikow says.

STORMING MAD HP employees protest in Grenoble

FRANCE

HP'S FRENCH TWIST

Why its plan to lay off 1,200 in France has reverberated all the way up to President Chirac's office

SHOCK WAVES HAVE BEEN emanating from Grenoble ever since mid-September, when U.S. tech giant Hewlett-Packard Co. announced it would eliminate more than 1,200 jobs in France. A big chunk of the cuts is likely to come from this pleasant city of 425,000 in the French Alps, where HP employs 2,400 people, about half its French work force. Angry HP workers poured into the streets when they learned of the plan, and Grenoble's mayor on Sept. 20 led a delegation to HP's Palo Alto headquarters, where he received a polite but noncommittal reception.

The protests didn't stop there. HP's European brass were summoned to Paris on Sept. 26 for a meeting with France's Labor Minister. Prime Minister Dominique de Villepin suggested that companies might be required to sign a "code of conduct" limiting their ability to lay off workers if, as in HP's case, the government f nanced road works and other improv ments benefiting their factories. Preside Jacques Chirac even asked the Europea Commission to intervene, although h request was quickly rebuffed. HP, for i part, appears undeterred. "We all kno how politicians are. For better or f worse, this has provided them a platfor to get some air time. But we don't feel it going to impact our ability to do wh we've announced," Todd Bradley, exec

ve vice-president of HP's ersonal Systems Group, ld an investors' conference in San Francisco on ept. 22.

Grenoble seems an unkely site for such an uproar. or more than a decade it as billed itself as France's nswer to Silicon Valley—nd with good reason. It is a orld-class research center, ith scores of public and ivate labs studying everything from adnced materials to microelectronics. In lleys leading out of the city, cow pasres have given way to office parks and eaming factories run by multinationals ch as Royal Philips Electronics and Microelectronics, as well as successful cal companies such as Sofileta, a manucturer of high-tech industrial textiles, d IT company Groupe Silicomp. At 7%, Grenoble's unemployment rate is ll below the national average of 10.1%. e tech workforce of 25,500 is set to ow over the next few years as Grenoble d the surrounding Isère region get a ajor infusion of aid from Paris to enurage nanotechnology research and delopment. "Can the local economy abrb the shock from HP? Yes," says an-Paul Giraud, president of the Agency r Studies and Promotion of Isère.

So why all the protests? Politics, for e thing. Chirac and his government ve made fighting unemployment their domestic priority. News of the HP offs plays into national fears that ance is losing jobs to lower-cost counes in Eastern Europe and Asia. Comnies such as Philips and IBM have aldy eliminated hundreds of jobs in ance in recent months while expandg their payrolls in places such as land, China, and India. HP hasn't said ether any of the jobs in Grenoble will transferred elsewhere. But employees te the company has a fast-growing faity in Slovakia that performs some of same functions as its site in the enoble suburb of Eybens, which hanes an array of functions from customer pport to software development.

Eric Gaudé, an engineer at the Eybens ility, says that many laid-off workers ld probably find other jobs in the area—ugh probably not as high-paying as at , where employee unions say the aver annual salary is about $48,000. The per fear, he says, is that HP, which first up shop in Grenoble in 1971, will evenlly shutter most of its operations here: ere's a sense of treason."

Is France's version of Silicon Valley on shaky ground?

Grenoble's authorities have complained bitterly that when HP wanted to expand the Eybens site in 1998, local governments spent more than $2 million to acquire and clear a piece of adjacent property that they then resold to the company for less than $500,000. Patrick Starck, the president of HP France, says HP never promised to create jobs in exchange for the assistance. Moreover, he says that over the past decade HP has paid more than $840 million in French taxes, including about $90 million to the municipality of Eybens. "We've been a good citizen," he says.

Dig a little deeper, and there's still another reason for Grenoble's angst. Despite generous seeding from Paris, the Silicon Alps region has not developed the rich ecosystem of high-tech startups and spinoffs that makes Silicon Valley's labor market so resilient. True, government research sites such as the Laboratory for Electronic and Information Technology (LETI) have served as incubators for some successful startups. One is Soitec, a 13-year-old company with $167 million in annual sales that is a world leader in supplying advanced insulation technology to the semiconductor industry. Yet unlike Silicon Valley, it's relatively rare in Grenoble for people to quit their jobs at one of the big high-tech outfits and take a stab at starting their own businesses. Of 48 recent high-tech startups listed by the local economic development agency, only a dozen were spun off from other companies, while the rest were hatched at government labs.

"France does not have a culture of risk and entrepreneurship," says Alain Lefebvre, one of four former HP employees who started VoluBill, a Grenoble-based company that provides customer-billing technology to mobile-phone operators.

Risk aversion may be one part of the problem, but government regulations are another. Even a startup like VoluBill, with 55 employees, has to give two months' paid vacation to its employees because of worker-friendly French labor laws. Strict anti-layoff laws mean that workers at big companies have come to expect that their jobs are guaranteed for life—unless the company pays them handsomely to leave. That's what happened at HP in 2003, when the company eliminated 1,300 jobs in Grenoble through early-retirement plans and buyouts that topped $250,000 for some workers. Under those conditions, it's hardly surprising that few employees strike out on their own.

The outlook for Grenoble isn't all gloomy. The pace of high-tech business creation has picked up since 1999, when France passed legislation allowing government researchers to take leaves of absence to start innovative businesses, says Jean-Bernard Schmidt, president of venture-capital group Sofinnova Partners in Paris. More recently, France's center-right government has started providing tax breaks to companies trying to commercialize new technologies, while relaxing some regulations on small businesses. For instance, in August, a new type of contract was introduced that allows companies with fewer than 20 workers to fire new hires more easily. Some 30,000 such contracts were signed in August alone.

French startups also are benefiting from greater access to venture capital. Sofinnova has financed recent startups originating from such French giants as defense and electronics group Thales and pharmaceutical maker sanofi-aventis Group. "The ingredients are now there," says Schmidt. But the allure of the Silicon Alps may no longer be enough to captivate HP and other multinationals. ■

–By Carol Matlack in Grenoble, with Peter Burrows in San Mateo

Silicon Alps

France's Grenoble region is a high-tech hotbed

INDUSTRY
High-tech businesses employ 25,500 people in IT, electronics, software, and nanotechnology

EDUCATION
Four universities and other advanced training centers enroll more than 61,000 students

RESEARCH
Government labs and universities employ 12,600 researchers; 4,500 more work for private companies

Data: Agence d'Etudes et de Promotion de L'Isère

INDIA

A QUIET SHOPPING SPREE OVERSEAS

So far, companies being bought by Indian players are small—but that may change

CHINA RAISED A STORM of controversy in the U.S. earlier this year when its cash-rich corporations announced their intention to buy oil producer Unocal Corp. and appliance maker Maytag Corp. At the same time, however, another Asian country, India, was also investing abroad, but with a minimum of rancor.

Indian companies have inked 62 overseas deals worth $1.38 billion so far this year, buying up a variety of foreign outfits, from engineering design house INCAT International in Britain to Valeant Pharma in the U.S. The Indian purchases have flown under the political radar because they average just $30 million and usually don't involve big-name companies. Still, the numbers are adding up. "Every day, even small-cap and mid-cap companies come to us wanting to buy companies overseas," says Manisha Girotra, India country head for UBS, which advises on such purchases. "Everyone wants access to new markets and to leverage India's low-cost production base."

FIFTH AVENUE Tata will manage New York's Pierre Hotel

Surprisingly, the biggest plays have not come from India's vibrant tech and outsourcing sector, but from more traditional industries like pharmaceuticals, farm machinery, and auto parts. Indeed, the biggest deal this year is odd: Bombay-based TV maker Videocon International Ltd. bought the color-picture-tube business of France's Thomson for $289.8 million. Yes, picture tubes are old technology, but Videocon, which makes picture-tube glass, will supply glass to Thomson's operations and integrate the businesses.

Most of India's recent acquisitions involve more modern technology. Leading the charge are drugmakers such as Sun Pharmaceutical Industries, Nicholas Piramal India, and Matrix Laboratories. Swati Piramal, chief scientific officer of Nicholas Piramal, predicts the drug industry will raise more than $3 billion in the next year for overseas acquisitions. In the biggest pharma deal this year, Mat bought Docpharma, a Belgian maker generic drugs, for $263.4 million.

Ten years ago, India's overseas g rush would have been impossible. T government in New Delhi imposed sev restrictions on the export of the countr foreign exchange—in part because th wasn't much of it. Today, India's boomi tech, auto, and pharma businesses ha attracted a flood of foreign investme The country holds $140 billion in serves, and curbs on foreign investme by Indian companies are largely go Predicts Amit Chandra, joint managi director for DSP Merrill Lynch Ltd., "T next three to five years will see the em gence of Indian multinationals."

REACHING FOR GLOBAL SALES

THE COUNTRY already boasts one am tious multinational: the $17.6 billion T Group, a conglomerate that includes te com, steel, autos, hotels, t and technology. In the l five years, Tata has sp more than $1 billion buyi Britain's Tetley Tea, Sin pore's NatSteel, U.S. te com network operator T Global, and INCAT. An was Tata that executed c of this year's toniest deals put down $50 million fo 30-year contract to mana the Pierre Hotel on N York's Fifth Avenue.

For smaller Indian co panies, overseas acqui tions are the road to glo sales. India's Sun Pharm with 2005 sales of $3 million, recently bou two U.S. drug compan to extend its already su stantial generic pharm ceutical business in t U.S. And Indian compan are also busy investi overseas in steel, a minum, and auto parts.

For now, the countr strategy involves small p chases and big ambitio But as Indian compan grow more confident, tha likely to change. It won't long before India raises global corporate pro and, like China, has to w ry about the political imp of its urge to merge. ■

–By Manjeet Kripal in Bom

Going Global

The top overseas acquisitions so far this year by Indian companies

BUYER	ACQUISITION	PRICE / MILLIONS
VIDEOCON TELEVISION MAKER	Thomson's color-picture-tube business, France	$289.8
MATRIX PHARMA COMPANY	Generic drugmaker Docpharma, Belgium	263.4
VSNL TELCO	TeleGlobe International Holdings, U.S.	178
TATA TECHNOLOGIES TECH	Software company INCAT International, Britain	94.5

Data: INDAT[illegible] Advisory Partners

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CASE STUDY:
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Around the beginning of the 20th century, society emerged from the late 19th century era of mechanization into one of rapid industrialization. The ensuing trend toward automation was in response to the social needs of the times and it was propelled by a strong focus on productivity, efficiency, sales, and profits. This vast wave of industrialization and then automation culminated in today's IT revolution and accelerated globalization.

In recent decades though, social needs have evolved, and people are thinking more about the quality of personal and working lifestyles as well as more about the issues left behind by industrialization. Many have asked the question, "Technology—For What?" The answer seems to be that society today wants more emphasis on developing and applying technologies that reflect consideration for people's aspirations and feelings as well as technologies that put more emphasis on harmonizing relationships between machines and people, between human beings and nature, and between the drive for efficiency and the need for creativity.

At OMRON, however, we have always believed that a new era would come, the era of the "optimization society," when people are once again put first and where security, safety, the natural environment, and health have the highest priorities. Our company motto is best summarized by the words of our founder, Kazuma Tateisi, who wrote in 1959, "At work for a better life, a better world for all." He was convinced that companies should stand for something more than profit generation. They should look to social benefit as the compass for guiding their strategies and be proactive contributors to making a better life for all through their business activities.

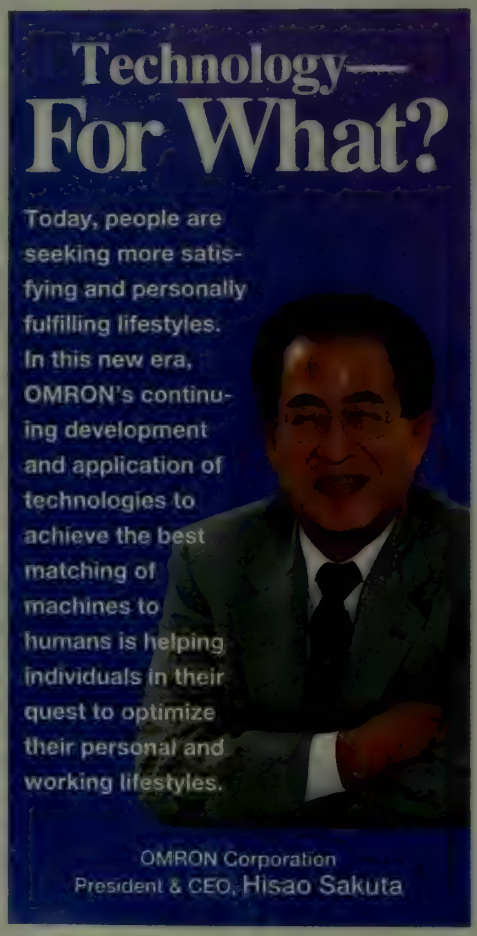
Throughout its history, OMRON has focused on identifying social needs and creating products that promote security, safety, the environment, and health.

In line with its company motto, virtually since its founding in Japan in 1933, OMRON has focused on being sensitive to and identifying social needs as well as creating products that contribute to fulfilling people's dreams for security, safety, a sustainable natural environment, and health. The optimization society now emerging will be characterized by more focus on the individual, and people worldwide will put more emphasis on attaining lifestyles that are both satisfying and psychologically fulfilling.

With social benefit as its compass, OMRON has created many value-added products over the years. A key theme for OMRON has always been assisting manufacturers in automating production processes to enhance product quality and create a workplace where the tasks that machines can do are left to the machines, allowing human beings to pursue more creative and exciting tasks.

OMRON's main businesses are industrial automation, electronic components, automotive electronics, social systems, and healthcare. In each area, the key theme is growing and developing by satisfying social needs.

OMRON has grown its businesses by anticipating the potential needs of society and developing products based on its core sensing and control technologies to meet those needs. Through continuing R&D in the fields of sensors, control systems, and human behavior, OMRON has perfected sensors that exceed the capabilities of human vision and control technologies that approach the level of human knowledge and judgment.



In our largest business, industrial automation, we are Japan's foremost manufacturer of control equipment for automating factory processes and make important contributions to improving productivity, profitability, and the quality of work life in many industries. To build this strong position in industrial automation, we have worked closely with our customers to explore new possibilities bring their ideas to life through soci responsible manufacturing. Our approac always to bring our customers the latest th ing in sensing and control to help them quicker, more efficient, and smarter. Our g in industrial automation is to bring new po bilities to life in manufacturing every day.

In our automotive electronics busin too, we are striving to realize new po bilities as we work toward another of long-held dreams for society—creatin world free of traffic accidents.

Preventing collisions is a desire shared motorists, car manufacturers, and pedestri in countries across the globe. In response this social need, our automotive electron business, another of our major business s ments, has devoted many years to perfectin high-performance laser radar for use in inte gent cruise control systems.

In brief, our laser radar system emit beam of light forward from the vehicle. A bounces off vehicles or other objec OMRON's sensing and control technolog go into action to compute the distance to object. The technology has high detection s sitivity, and a two-dimensional wide detect area unlike any currently available syste enabling accurate operation at most times day, even in smoky, foggy, or dusty con tions. Incorporated into intelligent cruise c trol systems, this laser-based system provide vital assistance to drivers in preve ing collisions.

We committed ourselves to developing t laser radar over rival technologies because lower cost means that car manufacturers meet the needs of an even wider market, m ing it optimal from both a business an social standpoint.

We at OMRON think the answer to t question posed in the title, "Technology— What?" is that technology should satisfy soc needs and contribute to the creation of pr ucts that enhance security, safety, the envir ment, and health. Why? First, because in "optimization society" people worldwide w put more emphasis on attaining better life a work styles. But also because it is just go business—for all our stakeholders. Good e dence of this is that for the year ended Mar 31, 2005, OMRON's consolidated net sa grew 4.1%, to US$5,687.7 million, operati income expanded 9.2%, to US$524.4 milli and return on equity rose to 10.4%.

More information on all aspects of OMRON's activities is available at
www.omron.com

EDITED BY ROSE BRADY

Chávez' Oil-Fueled Revolution

T SEEMS THERE'S no stopping Venezuelan President Hugo Chávez. He's already curbing the power of the big oil companies operating in Venezuela. Now he's stepping up a program of expropriation that could bedevil a number of businesses, both locally owned and foreign. ¶ The moves come just as Chávez seems prepared to further consolidate his power at legislative elections in December. The pro-Chávez coalition hopes to increase its majority in the 167-member National Assembly by more than 20 seats, to around 110. "It's going to be a battle for us," concedes Gerardo Blyde, a legislator from the opposition First Justice Party.

The opposition has pledged to join forces for the elections, but remains discredited after last year's defeat in a referendum that attempted to oust Chávez from office. If voters reward Chávez with a big win, as expected, the way will be clear for sweeping new moves in his Bolivarian revolution—his populist effort to tap Venezuela's oil wealth to impose socialism in the country. "Chávez is dead set on his revolution; there's no turning back," says Aníbal Romero, a political scientist at Simón Bolívar University in Caracas. "The question is how fast and how far."

CHAVEZ
Socialism is on the fast track

Food fight

CHAVEZ IS MOVING quickly. He has been boosting spending on health and education since coming to power in 1999, but he is now increasing government control of the economy, to investors' dismay. Oil companies with operating contracts in Venezuela, such as Chevron and BP PLC., have been ordered to set up joint ventures controlled by state oil company Petróleos de Venezuela (PDVSA), and royalties have been hiked from 16.7% to 30%. Chávez now has targeted more than 700 plants, particularly in the food industry, that are idle or not operating at capacity for possible expropriation. On Sept. 26 the state seized control of a plant operated by Alimentos Polar, the country's No. 1 private food manufacturer. "This is an unfair and arbitrary expropriation," Polar President Lorenzo Mendoza told reporters, adding that the facility was operational. The move followed the seizure of a shuttered H.J. Heinz Co. tomato processing facility. The company is negotiating to sell the plant to the state. Chavez defends the moves. "We will only expropriate what is necessary," he said in a recent speech.

> Chávez also threatens to turn rich landowners' land over to the poor

The President is also going after rich landowners. Authorities recently began taking control of 21 large ranches spread over hundreds of thousands of acres. Chávez has threatened to hand part of the land to poor Venezuelans unless owners legally document their ownership and show that their spreads are being productively used. In another shock to investors, Chávez disclosed plans to review—and possibly revoke—mining concessions and create a national mining company. The news caused shares in Canada's Crystallex International Corp., which has operations in Venezuela, to plunge 52% from Sept. 19 to Sept. 28. "What happens here in Venezuela will undoubtedly have some impact on the commercial decisions of companies, not just from the U.S. but from all over the world," U.S. Ambassador to Venezuela William Brownfield told reporters in Caracas. "Nationalization is a step backward," adds a State Dept. official in Washington.

It may sound risky, but Venezuela can afford it. Gross domestic product soared 17.9% in 2004 as the country rebounded from two years of recession following a long strike at the national oil company. Growth of 6.5% is forecast for this year and next, says Efraín Velázquez, president of the National Economic Council. Thanks to a new law, Chávez can dip into the country's $32.6 billion in international reserves for social spending.

How to win friends

WHILE CHAVEZ goes out of his way to irritate President George W. Bush—he's a close friend of Fidel Castro's—he's using Venezuela's wealth to win support in his neighborhood. His Petrocaribe initiative offers 196,000 barrels of oil a day to 13 Caribbean countries—including 98,000 to Cuba alone—with long-term financing options. He has set up the Petrosur alliance with Venezuela, Brazil, and Argentina to work on joint oil exploration and development. A similar alliance could be forged with Colombia, Peru, Bolivia, and Ecuador. PDVSA is looking to invest in half a dozen of the region's oil refineries.

Chávez, 51, is up for reelection in 2006, and he vows to stay in power until at least 2021. Critics say his shakeup may redistribute income from the rich and middle classes to the poorest, but the spending won't be sustainable if oil prices tumble. "With oil prices this high, Chávez doesn't need investment," says Miguel Octavio, director of BBO Financial Services, a financial advisory firm. "But if they drop by $15 or $20 [a barrel], there will be problems." Annual foreign direct investment has fallen from $5 billion in 1998 to $1.5 billion last year, according to Central Bank figures. The President's bet is that he'll transform his country without foreign investors and before the oil markets shift. With Venezuela's opposition so divided, Chávez' experiment could continue for years. ■

–By Stephen Ixer in Caracas

ON THE GRILL An audit found $1.25 million in "disallowed expenses"

Red-Faced At Red Robin

The resignations of two top execs cloud the fast-growing chain's future

RED ROBIN GOURMET BURGERS prides itself on a culture of what it calls "unbridled acts." The company's former CEO, Michael J. Snyder, came up with the concept after watching an unbridled horse run free in the high mountain desert of Idaho. Snyder uses it as a metaphor on the Red Robin Web site: "What if our company could run that same way with power and grace, no restraints, yet everyone knowing the direction and objective? What if we could be 'unbridled' in everything we do at Red Robin?"

But the unbridled act dogging Red Robin these days isn't one you'll find Snyder waxing rhapsodic about: On Aug. 11, in the wake of an internal audit that turned up what a company press release describes as $1.25 million of expenses "inconsistent with Company policies or that lacked sufficient documentation," Red Robin said the 55-year old Snyder was retiring after 26 years at the chain. The company, which turned over the issue to the Securities & Exchange Commission, said the expenses involved "use of chartered aircraft and travel and entertainment expenses, including charitable donations." James P. McCloskey, senior vice-president and onetime CFO, resigned at the same time. Neither exec responded to *BusinessWeek*'s requests for comment.

STILL THERE Ex-CEO Snyder, who owns 9.5% of the company, is staying on as an unpaid consultant

Until those revelations, Red Robin was a Wall Street darling. With a menu that includes "gourmet" items such as Whisky River BBQ burgers and grilled salmon burgers, the chain, with more than 275 restaurants, enjoyed healthy per-store growth rates. Its stock jumped from a 2002 initial public offering price of $12 to just under $63 this past June. But the exits of Snyder and McCloskey were just the start of the bad news. The same day the company announced the duo's departure, it also lowered its annual earnings forecast. Red Robin's stock plunged 24% in a day.

Snyder has had a long and profitable relationship with Red Robin. In 1979 he opened a franchise in Yakima, Wash., with his brother Steve. By 1995, Snyder was Red Robin's largest franchisee, with 14 outlets. That's when he approached Red Robin's Tokyo-based owners with a proposal to overhaul the slow-growing chain. In 1996, in exchange for injecting some cash, Snyder was named president and got a minority stake. He closed underperforming restaurants, added high-ticket items, and refinanced the chain's hefty debt.

Between 1997 and 2000, when Snyder sold his franchises to the company for some $24 million, earnings jumped 63% to $189 million, while net income went from a loss of $8.6 million to a profit of $15.4 million. The torrid pace continued. Average annual profit growth of 48.7% for the three years ended this past May helped land Red Robin the No. 96 spot on *BusinessWeek*'s 2005 Hot Growth ranking of the fastest-growing small companies.

HOT GROWTH COMPANIES

From the outset, Snyder enjoyed a trusting relationship with the six-person board, five of whom the company says were independent. In addition to his $1.1 million paycheck and his stake in Red Robin (now 9.5%), Snyder also owns a 31% stake in a large franchisee, Mach Robin, which owns Red Robins in the U.S. and Canada. That's a potential conflict since franchisee Mach Robin and franchisor Red Robin are on opposite sides in many business transactions. Last year the board waived its ethics code governing conflicts of interest to let Mach Robin build another restaurant outside of Boise, Idaho. In an SEC filing, Red Robin states that "The Audit Committee determined that the terms of agreement were no less favorable to the company than the terms that could have been negotiated with other, unrelated parties." A board spokesman declined comment.

Earlier this year, after reading newspaper reports about execs misusing their

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RED ROBIN'S FALL

The CEO's scandal-induced retirement on Aug. 11 hit the stock hard

Data: Bloomberg Financial Markets

company's private jets, Red Robin instructed its law firm to review Snyder's travel logs, says a company insider. Snyder's contract allowed him use of a leased corporate jet but required that he pay for private travel. In a conference call with analysts, the company said Snyder had repaid the $1.25 million and that McCloskey resigned after he was shown results of the audit.

Snyder is no longer the head of Red Robin but will stay on as an unpaid consultant. "Mike is going to assist us in brand work, as he always has," said new CEO Dennis B. Mullen, a longtime restaurant exec, in the conference call. Snyder won't be involved in day-to-day business, but "Red Robin is his life, and he's a huge shareholder."

The company has moved to improve its corporate governance. On Sept. 8 it beefed up its board, adding a pair of certified public accountants with experience in SEC compliance. That hasn't stopped the inevitable lawsuit charging that the company issued "false and misleading statements" before cutting its earnings projections. The suit also alleges that Snyder and McCloskey benefited by selling shares before Red Robin issued the lower outlook for 2005. SEC filings show that Snyder sold $14 million in stock through prepaid forward contracts in May; McCloskey sold $1 million in late 2004 and early 2005. In legal papers, Red Robin's lawyers call the suit "frivolous."

The tumult isn't slowing Red Robin's plans. The chain aims to open 15 new joints this year. Sales are up 23.4% in its most recent quarter, with same-store sales up 4.8%. "This is a strong company with a tremendous future," Snyder said to analysts after Red Robin announced his resignation. Maybe so. As CEO, Snyder created all the right buzz for the brand. But now the question he's getting is the kind that no business leader wants. ■

By Kenneth Green in Los Angeles

Wooing the Starbucks Crowd

To reverse sliding sales, big coffee brands aim to bring the café to the kitchen

ROBERT WOOLF, A 29-year-old ad writer in Parsippany, N.J., spends $40 a week on Starbucks lattes. Gas prices are climbing, though, and his salary isn't, so he's cutting back. Still, Woolf won't be turning to Maxwell House or Folgers for his fix. "I don't know anyone outside my Dad's Lions Club who drinks that stuf

Woolf and other steamed-milk-lovi consumers have confounded big cof marketers such as Kraft Foods, Procter Gamble, and Sara Lee, which have se their core coffee brands erode in the fa of the juggernaut that is Starbucks. the past two years, Kraft's Maxw House alone has lost about $75 milli in supermarket sales. Niche brands, li

TASSIMO Kraft's entry also delivers steamed milk, chocolate, and tea

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Kraft Food Inc.'s Gevalia and Procter & Gamble's Millstone haven't moved the needle enough.

The truth is, the Starbucks effect, which has turned coffee bars into workplaces and study halls and gotten consumers hooked on richer, pricier brews, has thoroughly disrupted the mass market. Now the big food companies are realizing they need a new game plan to tackle the coffee-out phenomenon.

So the big bet now is gadgetry. The food companies are teaming up with appliance makers to take the biggest step forward since Mr. Coffee replaced the percolator. The newest entry about to hit stores, Kraft's Tassimo, aims to create some of the café mojo on kitchen countertops that people seek at the corner shop. The slickly designed push-button single-serve coffeemaker that delivers premium coffee, espresso, latte, chocolate, and even tea, was carefully developed over four years. Priced at $169, it's well above most rivals' systems in the hopes of being taken seriously by coffee aficionados without pricing itself out of the family budget. The quality brew comes in special "disks" that sell for 44¢ to 99¢, and Tassimo has the only system that makes cappuccino with real steamed milk. Starbucks may have ambience, but half its customers just grab and go. For them, the java matters more than the Wi-Fi link. Says a confident Howard Friedman, a Tassimo U.S. executive: "Tasting will be believing."

FRANCE FIRST

NONE OF THESE companies thinks it can outdo Starbucks, but they are out to learn from its success. Nothing less than a generation of coffee drinkers is at stake. According to a survey by Greenfield Online Inc. for *BusinessWeek*, 63% of adults age 25 to 44 regularly go to pricey coffee bars. The number of those cafés has jumped from 15,400 in 2002 to 18,600 last year. Starbucks, which has almost 7,000 outlets in the U.S. now plans to eventually have 15,000. And sales of specialty coffees like Green Mountain Coffee Roasters Inc. and New England Coffee Co. keep climbing, hitting $9.6 billion last year, a growth rate of 7%. Kraft especially sees the fallout. Its own mass brands are sliding, but the Starbucks beans it distributes increased sales by 18% through Sept. 4, to $200 million, according to Information Resources Inc.

It has come to the point that drinking or serving a mass brand of coffee is getting to be like serving Pepsi on linen tablecloths. And the Starbucks phenomenon has extended beyond urban centers as coffee chains are finding an audience for $3 cups of joe on interstate highways, college campuses, and even among blue-collar drinkers. "The taste of the whole American public has been lifted, and Starbucks deserves a lot of the credit," says Mark Pendergrast, author of *Uncommon Grounds: The History of Coffee and How It Transformed Our World*.

In fact, despite the dim view of Starbucks held by the French and Italians, its influence has propelled American preferences toward those of Europeans—for deep, rich Arabica-style roasts and espresso drinks. So Kraft faced an especially tough audience when it went to France last year. Researchers hooked machines in French households to monitors to record how often the machine was used, what drinks were brewed, and at what times of day. Kraft will do the same in the U.S. in hopes of maximizing coffee sales and outdoing Sara Lee Corp.'s Senseo system and P&G 's Home Caf

Though Senseo is a hit in the Nethe lands, where it's found in half of households, it has been slower to catch in the U.S. In the 19 months Senseo h been on shelves stateside, it has so about 400,000 machines, a sliver of t 19 million coffeemakers sold annually the U.S. And while Sara Lee and P&G t gether spent $60 million on ads for the products since 2004, according to TN Media Intelligence, they have sold on $20 million worth of their branded po in grocery stores.

Selling more of their coffee refills to t masses, especially 25- to 45-year-ol with a lot of caffeine cravings ahead, the whole point. In a nod to Gillette proven razor-and-blade strategy, the id is to get people hooked on the brand premeasured coffee "pods" and "disks Home Café and Senseo pods are inte changeable, as well as those from oth companies. But Kraft opted for its ov proprietary "disks" that will be limited its own brands like Maxwell Hous Gevalia, and Suchard, as well as Twinin tea (Kraft doesn't have its own t brand). Kraft concedes it limits choice b figures the quality control is worth it.

But can any kitchen coffeemaker di place the java jive atmosphere and bra cachet of Starbucks with its music tie-i and Wi-Fi Internet connections? A Robert Woolf. "If the coffee really is goo I can download a lot more music wi what I'll save." ■

–By Adrienne Carter in Tarryto N.Y., with David Kiley in New Yo

New Brews

Now that cafés are as ubiquitous as McDonald's, food companies are fighting back with new single-serve coffee-making systems that require refills of their beverage "pods" and "disks."

TASSIMO

Price: $169 for the machine, distributed by Braun, and 44 ¢ to 99¢ for disks.

KRAFT is launching the Tassimo in department stores and specialty retailers. Instead of traditional advertising, it's opting for in-store sampling to create buzz.

HOME CAFE

PRICE: $40 to $120 for the machines and 20¢ to 62¢ for Folgers and Millstone pods.

PROCTER & GAMBLE teamed up with three manufacturers, including Krups, on the systems, sold by major retailers from amazon.com to Wal-Mart Stores.

SENSEO

PRICE: $70 for the machine, made by Philips, and 24¢ to 26¢ for the pods.

SARA LEE hopes to replicate its success in the Netherlands, where the Senseo is in half of all households. Each cup has a layer of froth on top to create a café feel.

BusinessWeek online For a look at single-serve coffeemakers and the results of a taste test, go to www.businessweek.com/extras

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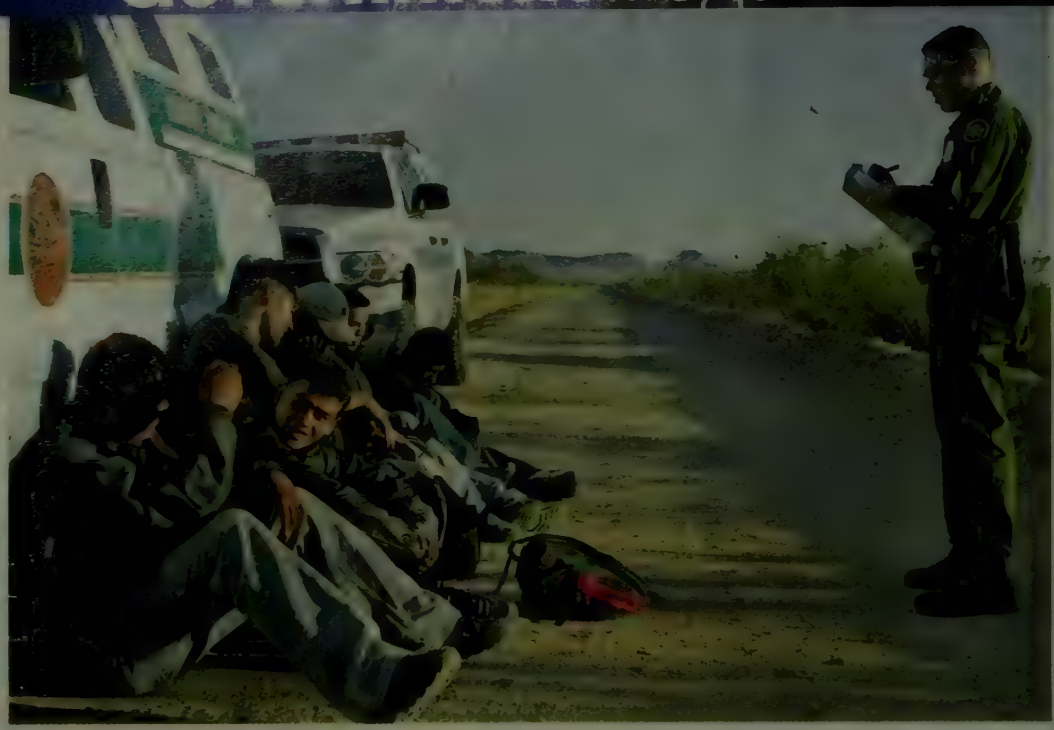

HIDE-AND-SEEK Agents play a losing game in the Sonoran Desert

Whipsawed On the Border

As illegals pour in, the interests of business and ire of citizens are colliding

IN THE SONORAN DESERT, along the border that separates Arizona from Mexico, the game of hide-and-seek between aliens and Border Patrol Agents is getting increasingly deadly. Over the past year, 201 illegals have perished in the brutal heat as they attempted to cross the searing desert floor. Pima County's overwhelmed coroner has had to rent a refrigerated semitrailer at $1,000 a week to serve as an overflow morgue.

This so-called Tucson sector is a 261-mile stretch where the Border Patrol captures as many aliens as in all the rest of the eight other border sectors combined. So far in the past 12 months, 435,589 men, women, and children were apprehended there—and mostly sent back south. That's enough people to populate a major American city, and the number underscores a new report by the Pew Hispanic Center in Washington that says illegals now outnumber legal immigrants.

In the other enforcement zones, agents monitor cameras and check documents from 33 air-conditioned checkpoint booths situated along the key roads that illegals favor. Agents can run computerized checks of fingerprints and license numbers and detain illegals in holding cells. But in the Tucson sector, things are different. With temperatures sometimes soaring to 130F on the pavement of the interstate, agents must make do with traffic cones, water-cooled outdoor fans, and aluminum canopies used to shelter drooping search dogs. A recent visit to a stifling trailer revealed computers jury-rigged to car batteries and not connected to headquarters data banks. As for cellphones? No land lines, and cells don't always work.

The state's chief Border Patrol agent, Ronald S. Colburn, a be 27-year veter with two stars his collar, cha at the lack checkpoints a likens it to playing football witho a defensive backfield. "If you do have [a checkpoint], the other tea will just run right over you," says. Since they block key roadw access points north, fixed che points force smugglers and th human cargo to leave the highw and walk through the rough terr and mesquite, where they can detected by aircraft, remote cont cameras, and ground sensors. July, 2005, report from the nonp tisan Government Accountabil Office found that the lack of fix checkpoints in the Tucson sector duces effectiveness. Even w 2,400 agents patrolling his zone, Colbu concedes that outside a few border tow the U.S. still lacks "operational control," part because of a porous checkpoint s tem. For every alien caught in the desert. least three probably make it through, a cording to rough estimates.

THE STAT

435,589

Number of illegals apprehended near Tucson in the past 12 months

REAL ESTATE VALUES

SO WHAT'S THE HANGUP? For the pa five years running, the restriction checkpoints along the Sonoran Des has been quietly built into Border Pat spending bills by a senior member of t House Appropriations Committee, R publican Representative Jim Kolbe Tucson. Kolbe, an outspoken foe of il gal immigration and champion tougher border controls, acknowledg blocking checkpoints for his district b insists he's not trying to "micro-mana the Border Patrol." Instead, he says, h responding to constituents who object a system of highway checkpoints th they feel can clog traffic. Nonsens replies T.J. Bonner, president of the N tional Border Patrol Council, a uni representing 6,500 agents. Kolbe may a hardliner on illegals at home, but Washington, "[he] is s on illegal immigration.

Kolbe's dilemma b comes more apparent Tubac, an artsy encla just off Interstate 19. A fo mer artist's colony, whe dilapidated housing a land were once dirt- chea Tubac is being develop as a luxury resort wi houses on a minimum

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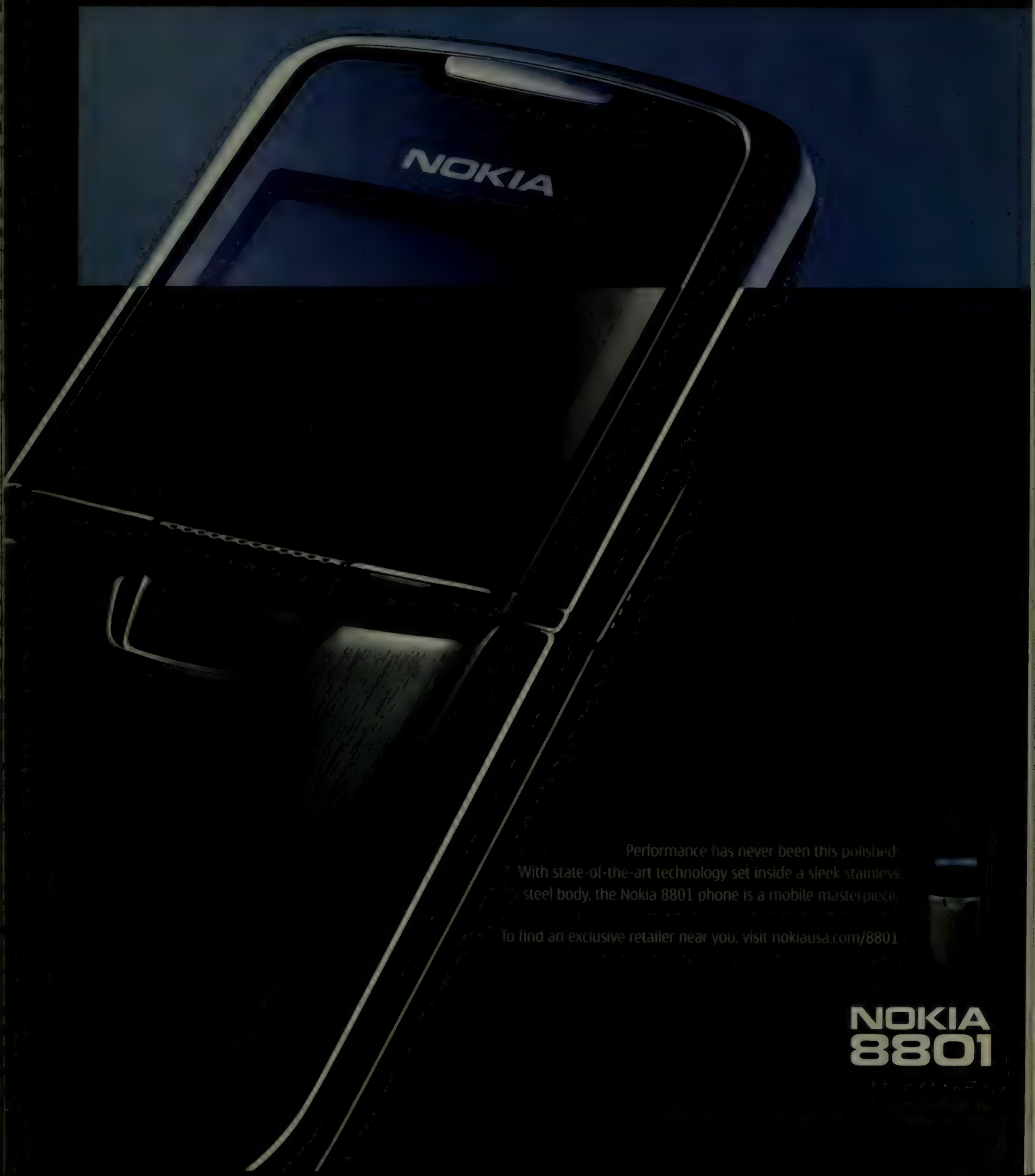

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Sharon Lynn Kagan

Marx Professor of Early Childhood and Family Policy; Co-director, National Center for Children and Families; and Associate Dean for Policy, Teachers College, Columbia University; and Professor Adjunct, Yale University's Child Study Center. Kagan, one of the most compelling voices in early-childhood education, is one of the field's leading scholars.

Ellen Moir

Founder and Executive Director, New Teacher Center, University of California at Santa Cruz. Moir is the preeminent expert in high-quality induction programs leading to more effective teachers and greater retention rates for beginning teachers.

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The McGraw-Hill Companies

ır-acre lots and a new golf course. The erage asking price for existing houses is eady $637,000, but one recently sold for 2 million. Officials and businesspeople, o asked that their names not be used cause they want to maintain good relans with Kolbe, say that developers obted to the Border Patrol checkpoints for e simple reason: They feared the show guns and badges could scare off "snowds" from up north who might not be pared to live on a major illegal immition route.

Kolbe concedes that he is being whipwed by constituents. He fields comints from ranchers along the border pset by [the aliens] cutting their ces and puncturing their water tanks d leaving trash and cutting trails." In t, Kolbe's desert cabin near Nogales s been repeatedly burglarized by illes. On the other hand, when the Bor Patrol arrested eral busloads of gal migrants ded to the lete and pepper ds in western zona, Kolbe ard from the stern Growers n., too. "It used be that everydy winked at" daily flow of kers from Mexihe says.

KOLBE Everybody used to wink at illegals

The contrast been Kolbe's hard rhetoric and his actual record is nptomatic of the predicament in which Republican Party finds itself. Despite ging GOP calls to crack the whip, busis lobbies, particularly those represent the retail, construction, tourism, and dscaping industries, are pushing to p a steady flow of low-wage workers the labor pool. If the liberal approach Arizona's usually conservative congresnal delegation is any guide, business ms to be prevailing so far.

Kolbe and House colleague Jeff Flake, well as Senator John McCain (R-Ariz.), co-sponsors of a bill that seeks to nt partial amnesty to illegal workers. zona's other Republican Senator, John , backs a slightly tougher measure that uld still create a guest-worker gram. President Bush, who is expect to mount a new push for partial nesty in a matter of weeks, will try to isfy both his worker-hungry business es and his party's plan to enroll more turally conservative Hispanic voters.

Arizona business leaders and pro-immigration groups back the partial amnesty and guest-worker concept. Tourism and construction, the "key drivers" of the state economy, are heavily dependent on immigrant labor, says Barry G. Broome, chief executive officer of the Greater Phoenix Economic Council. "The illegal workforce can be converted into a positive development."

ROCKS AND GUNS

BUT MANY ILLEGALS can't be so easily turned into upstanding citizens. Of the aliens caught sneaking over the border in the Tucson sector during the past 12 months, 31,000 had U.S. criminal records, Border Patrol figures show. The immigration trade is now dominated by professional smugglers who move humans and drugs north using vehicles stolen by organized gangs. The Phoenix area has the highest rate of auto theft in the nation, according to police and auto insurers. Smugglers resist arrest, sometimes with rocks or even gunfire against agents who generally patrol alone in remote regions where backup can be an hour away. Agent James A. Hawkins recently surprised a group of 30 illegals whose guide ordered them to throw rocks. "Big skull-crushers," recalls Hawkins, a slim 36-year-old. This year, agents have logged 241 assaults, twice last year's 118.

At a temporary interior checkpoint on I-19, some 24 miles north of the border, the debate over tactics comes into sharp focus. In the shimmering heat, 18 illegal aliens, including two young women, all dressed in long pants and heavy shirts against the sun and the mesquite thorns, huddle dejectedly under an awning. After drinking all the available water at the makeshift checkpoint, they wait for a Border Patrol van to take them to Nogales for processing and then a trip back south. A *coyote* or smuggler had dropped them off with instructions on how to skirt the checkpoint, but the group was easily spotted waiting for the final ride north. Score one for the feds. Still, shrugs one agent, the odds are high that most of those who got tagged will soon be back for another risky round of hide-and-seek. ■

–By Paul Magnusson in the Sonoran Desert

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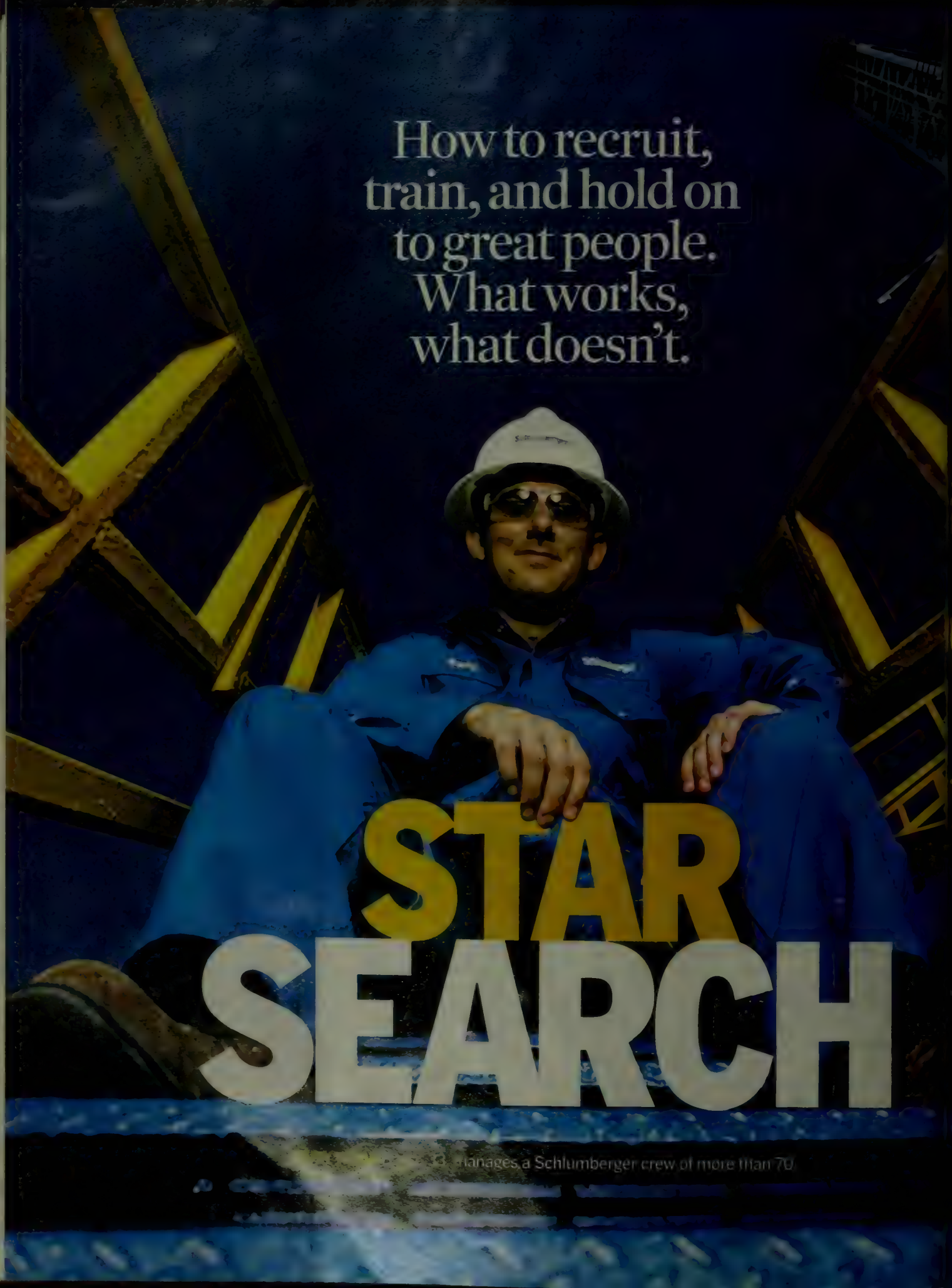
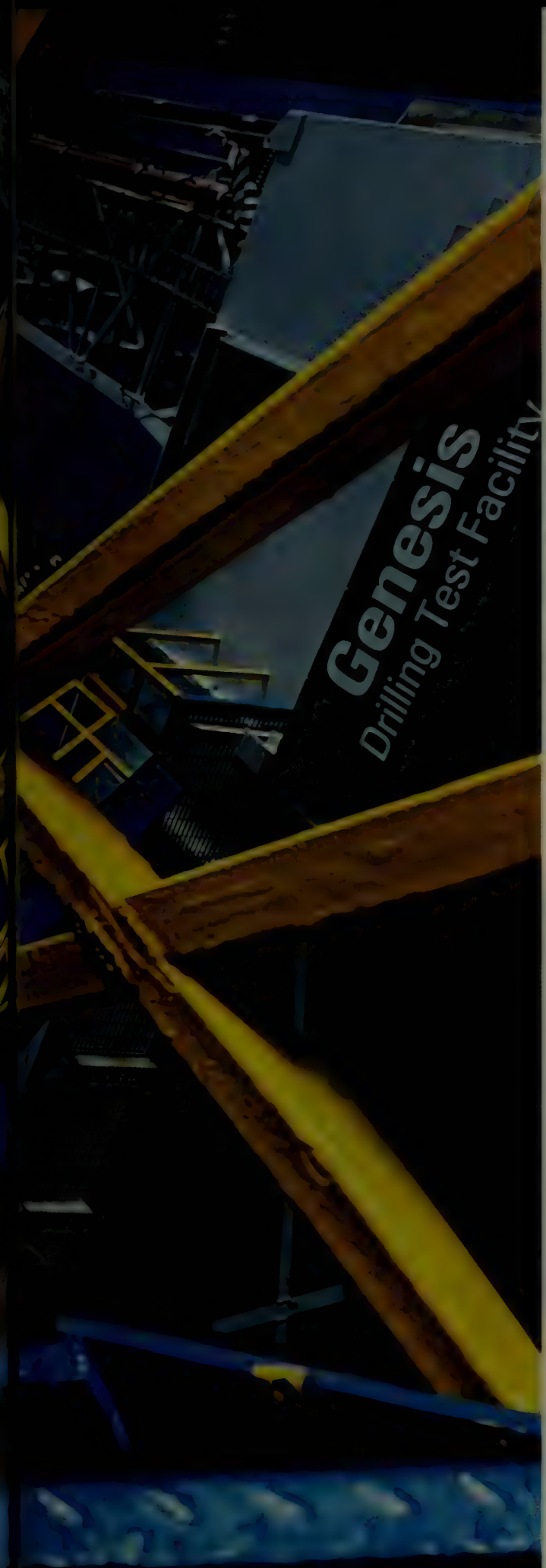


anages a Schlumberger crew of more than 70.



BY NANETTE BYRNES

WITH OIL DANCING CLOSE TO $66 A barrel on the open market, companies are now exploring the remote spots that hold most of the world's untapped supply. After several years of record profits, the energy giants have plenty of cash to finance the dig. The main thing holding them back is a resource scarcer than crude: engineering talent. Because of layoffs in down times and opportunities in sexier fields of technology, fewer petroleum engineers are graduating from U.S. schools. A mere 1,500 are enrolled this year, down 85% since 1982—back when *Dallas* was the hit TV show.

This crisis is sparking a war for talent in the industry. Oil-field services giant Schlumberger Ltd., for example, recently lost a deepwater drilling expert to a client who tripled his salary. And that was before Hurricane Katrina slammed into the Gulf Coast. "The people shortage was extremely acute before Katrina and is now far worse," says Matthew R. Simmons, chairman of energy investment bank Simmons & Co., based in Houston, Tex. "The major oil companies are now poaching trained people from the service industry and no service company has better trained people than Schlumberger."

So is Stephanie Cox, Schlumberger's director of personnel for North and South America, sweating? Hardly. Through lean years and fat, her company has consistently focused on cultivating great people, and its bench is deep. Seated in the company's small outpost in Victoria, Tex., on a baking day in July—amid rice, corn, and oil fields—she demonstrates how easy it is for human resources executives at the company to pinpoint hot talent using an online system called PeopleMatch.

Cox sets a formidable, if hypothetical, challenge for herself: finding a country manager for Brazil. This is an employee who must be mobile, can speak Portuguese, and be "high potential"—meaning the candidate is judged capable of moving up two grade-level positions. (Currently, about 10% of Schlumberger staffers meet this standard.) Cox, a 36-year-old mother of two who radiates an aura of calm efficiency, enters Schlumberger's human resources intranet site and starts filling in a series of boxes, selecting those personal characteristics much as somebody might choose a hotel on an online travel site like Travelocity. Although the search may seem like a long shot, 31 names pop up within a minute.

Getting Personal

WHAT COX SEES ARE NOT mere résumés. Through Schlumberger's intranet, she has logged on to a database that marries human resources information concerning people's past job performance and salary with each worker's own curriculum vitae. Those résumés—which the company calls Career Networking Profiles—are far more fun and informative than typical corporate bios. All employees write their own, generally covering their career goals, family, past assignments, professional affiliations, publications, patents granted, and hobbies. Instead of the mug shots that populate most in-house directories, people often send personal photos. One man holds up a fish caught on vacation.

This is no off-the-shelf software. Schlumberger built the sys-

WYATT McSPADDEN

tem itself. And what Cox did can be done at hundreds of offices in 80 countries, from the arctic tundra of Alaska to the arid desert of Abu Dhabi. "The capacity to develop talent from anywhere in the world is one of our key strengths," says Chief Executive Officer Andrew Gould, himself a 30-year veteran of the company.

Plenty of CEOs preach the importance of talent, but Gould leads a congregation of true believers. Schlumberger is a rare company that has turned its human resources department into a strategic asset rather than an employee-irritating nuisance. Other standouts include midsize financial services firm Jefferson Wells International (page 78), IBM (page 72), Johnson & Johnson (page 76), and Dell (page 71).

Calling All Supernovas

THESE COMPANIES ARE all in different industries. They are different ages, sizes, and have their own growth strategies. But at bottom, all recognize that the secret of every high-performing company is great people—and that there aren't enough stars to go around. Consider the 20 companies that made Hewitt Associates' 2005 list of great places for leaders. All but two have beaten the Standard & Poor's 500-stock index companies' 156% total return to shareholders over the past decade. Some, like Capital One Financial (887%) and Dell (2,859%) have surpassed it by a mile. "Talent should be a weapon and should be used as a weapon," says Marc Effron, Hewitt's longtime leadership expert, now vice-president for talent management at Avon Products. "But it's amazing how little attention companies put into this."

No kidding. Despite years of rhetoric about talent—and stacks of annual reports insisting that people are a company's biggest asset—most companies still don't get it. Instead of making a long-term investment in their employees, corporate chieftains during the bubble years too often went for the easier short-term payoffs to be found in accounting games. And instead of devoting their own time to talent management, CEOs have often

PAID TO NURTURE Marmonti now spends more time mentoring

punted to outsiders who come with marketing software systems, executive coaching, and an endless array of overhyped turnkey solutions. Who hasn't gone through some form of this torture? The 360-degree review that is never followed up, or 150 question-long employee satisfaction surveys, or emotional intelligence evaluations that lead to exactly nothing.

Add it all up, and companies will probably spend $50 billion on talent development this year, according to Jay Conger, a professor at Claremont McKenna College and London Business School. Nevertheless, says Avon Products' Effron, "you tend to

TALENT OVER TIME

Trying to get the workforce right has led to more than a century of innovations—and fads

1881 BUSINESS GOES TO COLLEGE Joseph Wharton, co-founder of Bethlehem Steel, finds training workers hurts too expensive. He persuades the University of Pennsylvania to launch an undergraduate business education program.

1900 MBAs Dartmouth opens the first graduate business school. Ten years later, Harvard graduates its first class—of eight. By 2004, there were 120,875 MBAs awarded in the U.S., and many schools have opened overseas.

1911 TAYLORISM Frederick Winslow Taylor publishes *The Principles of Scientific Management*. The antithesis of touchy-feely management theory, it argues that there is only one objectively correct way to perform industrial jobs.

1943 EXECUTIVE MBAs University of Chicago offers the first MBA for working managers.

1950s OHIO STATE LEADERSHIP STUDIES Business theoreticians shift their focus from the factory floor to the executive suite. No longer concerned solely with efficiency, university researchers begin evaluating softer issues, such as how considerate, friendly, and supportive a leader is.

1956 CORPORATE CLASSROOMS Leadership development goes in-house at General Electric when the company opens its own management "school" in Ossining. In the 1990s, CEO Jack Welch grooms generations of top managers in its bowl-shaped auditorium dubbed "the pit," so successful that GE becomes a "leadership academy" supplying CEOs for Boeing, HomeDepot, and elsewhere.

1959 HELLO "KNOWLEDGE WORKERS" book *Landmarks of Tomorrow*, management guru Peter Drucker describes the decline in importance of manual labor and coins a term describing a new type of employee.

Data: [illegible] Department [illegible]

PHOTOGRAPHS BY WYATT McSPADDEN; (BOTTOM, L TO R) TOPICAL PRESS AGENCY/GETTY IMAGES; GRANGER COLLECTION, NEW YORK; LEE CELANO/THE NEW YORK TIMES; JUSTIN SULLIVAN/GETTY IMAGES; (BUSH) KEVIN LAMARQUE/REUTERS

ME SCHOOLED THE BRASS

As a member of the first classes of managers to go through Dell Inc.'s new Leadership Edge program, David Marmonti spent 10 days last September in Austin networking with 17 other fast-track executives, including three days of strategy talks with Chairman Michael S. Dell and CEO Kevin B.

Like many of the hypergrowth companies that shot up so quickly he tech revolution, Dell had long relied on sheer momentum to nagers like Marmonti challenged and the company humming. As om startup to powerhouse at lightning speed, Dell could ignore ies of human resources development. People were dying to work dynamic company. Stock options were making millionaires of l managers.

s Dell, now with $49 billion in sales, charges toward its $80 billion goal, growth is getting harder—and more of it will come far from its Austin (Tex.) roots. Dell and Rollins realized three years ago that the company's once magic combination of high-quality goods, low prices, and super-lean efficiency would no longer suffice; they had to figure out talent management as well. They ordered up a new training program, designed in-house, and taught primarily by Dell's own top managers, including themselves. The two chiefs submitted to 360-degree assessments in the hope of inspiring their executives to do the same. Pay is now determined in part by how well a manager does at nurturing people.

As a result, Marmonti has rearranged the way he does his job. He now spends 30% to 35% of his time on people, more than in the past, and personally mentors many more managers. "Once we understood the type of leaders and numbers we would need, we looked inside our business and said, 'Do we have what we need to get there?' " says Marmonti. He continues to have a coach and get regular feedback on his own performance, part of the long-term component of Leadership Edge.

Although not enough time has passed yet to know for sure if the broader program is working, Marmonti's group is doing well on the measurements that are available. Its score on Dell's employee satisfaction survey has jumped 20% in the last 15 months. The real test will be if Dell retains those employees and turns them into the next generation of leaders.

e people glomming on to the latest fad or thing they heard out in a conference. But the more you rely on consultants, the re likely you are to fail."

Nowhere is talent mismanagement more starkly in evidence n in the corner office. Hewitt found that 85% of its good npanies promoted their current chief executive from within npany ranks, but only 68% of the rest did. The worst-off ve to go outside over and over. Dial, for example, has looked tside for each of its past three CEOs, all while competing inst the renowned talent experts at Colgate-Palmolive and Procter & Gamble. Kasper Rorsted, vice-president of HR for Henkel Corporation, which bought Dial in 2004 and gets 95% of its leaders internally, says, "I would be very disappointed if the next CEO [of Dial] came from outside the company." Meanwhile, Coca-Cola Co. has screwed up in a completely different way—by picking the wrong insiders. In the past seven years, the company has had three different CEOs, and each of those Coke veterans has struggled and failed to renew the company's marketing zest. In the past decade, Coke has returned only 58% to shareholders, while rival PepsiCo Inc., a model of

8 SATISFACTION Does if workers are happy? In 30 book *Work Redesign*, Hackman and Greg argue that workers eaning and responsibility work to perform well.

80s 360° FEEDBACK rs are suddenly exposed ues from those below the hierarchy. ting these assessments s a big business for nts such as the Center tive Leadership.

1950 PAY FOR PERFORMANCE Investors rebel after the economic slump of the late 1980s cuts everyone's pay-except the CEO's. The "Pay for performance." backfires when incentive pay such as stock options give execs like **Larry Ellison**, who collected $781 million from 2000 to 2002, excessive windfalls.

MID-1990s EXECUTIVE COACHING Who can tell CEOs the things that everybody else is afraid to say? Executive coaches. Practitioners like Marshall Goldsmith, who charges more than $150,000 a year per client, have reached iconic status.

1997 EMOTIONAL I.Q. Daniel Goleman's best-seller, ***Primal Leadership: Realizing the Power of Emotional Intelligence***, launches an industry. Spin-offs include his consulting business (Emotional Intelligence Services), a workplace-satisfaction survey, and an online tool to help managers figure out what all that feedback means.

1999 JOB JUMPING Online job search hits the big time when **Monster.com** pays $1.6 million for a 30-second Super Bowl ad (above) that becomes a cultural phenomenon. Combined with the increasing heft of executive search firms like Heidrick & Struggles and Spencer Stuart, Web-based job boards have become a lubricant for an already disloyal workforce.

2001 THE OVAL CORNER OFFICE The first President to hold an MBA, **George W. Bush** is sworn into office.

2005 ACTION LEARNING Not to be confused with Outward Bound type team-building, this growing training practice is based on the premise that it makes more sense to put promising people to work on real business problems than to bore them with theoretical campus learning. They get trained and the company gets a problem solved. Adherents include J&J, IBM, and General Electric.

ON CALL IBM's database found Yarbrough for a health-care client

PINPOINTING INSIDE UP-AND-COMERS

IBM

Nestled within its forested corporate campus in Armonk, N.Y., an easy stroll from the CEO's office, is IBM's stone-and-glass leadership training center. Big Blue is one of those companies—along with General Electric Co. and Procter & Gamble Co.—that are often cited as the gold standard for talent management. But if the Armonk school is a window on IBM's human-resources history, its future is a technology-powered staff-deployment tool the company is calling its Workforce Management Initiative. Think of the system as a sort of in-house version of Monster.com, the online job site. Built on a database of 33,000 résumés, it lets managers search for employees with the precise skills they'll need for particular projects.

The Initiative, which applies what the company learned about logistics over its decades as a computer hardware manufacturer to its human assets, has already become much more efficient, saving IBM $500 million. It has also improved productivity. In February, for example, a health-care client needed a consultant with a clinical background. The system almost instantly targeted Lynn Yarbrough, a former registered nurse—a search that would have taken more than a week in the old days.

But the Initiative's greatest impact may be its ability to help managers analyze what skills staffers possess and how those talents match up to the business outlook. The goal is to train people ahead of anticipated changes. This year IBM will spend $400 million of its $750 million employee-education budget on instructing people in the skills it thinks will be hot in the future.

management consistency, has delivered close to four times that.

So failure is costly. And it is only going to become more so—because talent is growing far scarcer. According to consultant RHR International Co., the country's 500 biggest companies anticipate losing half their senior management in the next five to six years. There are too few bodies to replace them. As the 77 million U.S. baby boomers begin to retire, Generation X, now 24 to 40 years old, makes a paltry successor, with 46 million people. That demographic gulch has been dug deeper by the efficiency purges of the early 1990s, which wiped out middle management and taught laid-off workers that there was little reward for loyalty. The result? "There are very few companies that feel they have an excess of talent," says Paul Rogers, a partner at consulting firm Bain & Co.

40%

-plus of companies don't have a CEO succession plan in place

Data: Hewitt Associates

At the same time, business has gotten tougher, and companies are counting on their people to be flexible enough to move at today's accelerated pace, yet creative enough to excite consumers around the world—a tall order for a group that is already doing more than ever. Increasingly, profits come from overseas, with the global economy growing twice the pace of the U.S. and growth in developed markets is often in people-intensive industries such as technology, information, and communications. Last year this segment, although making up only 4% of the U.S. economy, accounted for 13% of its growth, according to the Bureau of Economic Analysis. In today's world, "the judgment of the employee has value," says Marcus Buckingham, a longtime Gallup consultant on HR.

Common Traits

SO WHAT IS A COMPANY TO DO? Is there a magic formula? The truth is that there is no template that works across all companies in all industries. But the standouts do have some traits in common. They all customize their own solutions with modest help from the outside. They put good people in human resources—in fact, it can be a fast route to the top at companies that care about talent. They focus on their best performers. And their commitment comes straight from the corner office.

For a close look at how all these themes weave together, there is hardly a better model than Schlumberger. The company, which had net sales in 2004 of $11.5 billion and net income of $1.2 billion, gets a premium for good management. T. Rowe Price analyst Tim Parker says good people and technology have traditionally garnered the company a value 20% to 25% above peers such as Baker Hughes. (T. Rowe Price is a major shareholder of both companies.) Those skills have helped the company overcome missteps, including large investments in technology outside the o

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patch, to return 241% to shareholders over the past decade, well above the S&P 500's 156% climb and that of most rivals.

Gould has spent almost all of his tenure as CEO focused on building up the company's already strong human resources department, a dedication to talent that extends all the way to field managers. When a high-performance person is lost, it warrants the same full-blown investigation as a technical mistake causing hours of expensive down time on an oil rig. The probe includes an exit interview, the results of which are put online, retrievable by managers throughout the corporate hierarchy. "We essentially treat attrition, especially if someone has a high potential, as a catastrophic incident," says S. Eric Bartz, 33, who manages the Victoria facility's crew of a dozen trucks and more than 70 people. Schlumberger's people "are a big investment," he says. "Huge."

Investigating Exits

TO MAKE SURE THAT IT GETS FIRST dibs on the best available talent and to help schools prepare students to meet high technical and quality standards, Schlumberger has assigned high-level executives as "ambassadors" to 44 important engineering programs. Among them: Massachusetts Institute of Technology, Kazakhstan's Kazakh National Technical University, Peking University, and Universidad Nacional Autónoma de México (UNAM). These ambassadors are generally high-ranking executives within the corporation, and they control substantial budgets, which they can use to help fund university research.

H. Sola Oyinlola, a Nigerian who in a 21-year career working for Schlumberger has held jobs on every continent except South America, is ambassador to Nigeria's University of Ibadan. The university has struggled during the decades of political upheaval in West Africa. Much of Oyinlola's work revolves around helping the university meet the company's educational requiremen Early in the relationship, he donated, on behalf of the compa several million dollars' worth of equipment, which the univer ty used to create a state-of-the-art petroleum learning center. day, Nigeria is a net exporter of engineering talent for Schlu berger, with more Nigerian engineers working for the compa around the world than foreigners working in Nigeria itself.

Schlumberger, which employs people from 140 nations, g points with clients, many of which are nationally owned, staffing locally. "It's one of the strong selling points of Schlu berger in Nigeria that it is not an imperialistic model," says Oy lola. That diverse and deep bench has also helped Schlumber enter tough markets like Russia and Angola early.

The company's 16 highest-level executives represent 10 d ferent nationalities. That diversity helps in an industry whe most of the growth is outside the U.S. Geoff Kieburtz, an anal at Smith Barney Citigroup who upgraded the stock to "buy"

Dive Deeper into the Talent Pool

"If only HR could figure out its job": Leadership guru Marcus Buckingham on why accentuating the positive gets better results than fixating on what's wrong

Thinking Outside the Boxes: The UPS internship program keeps execs focused on what things look like from the ground up

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WHAT NOT TO DO

Too much of human resources is painful, pointless, and costly. Here are four of the most common pitfalls:

INVENTING MAKE-BELIEVE METRICS

HR is far too often judged on activity rather than results—meaningless measures like how many executives attend development classes. Employees are smarter than that, and exercises with little follow-up are big morale-busters.

LESSON Leadership guru Jay Conger suggests **tracking the performance of the people a manager promotes.** If they don't do well, the manager is failing.

CRITICIZING RATHER THAN PRAISING

At its core, almost all HR **training is focused on finding out what's wrong with you and fixing it.** It's fine to work on mitigating weaknesses, but research shows better results for those who focus more time on natural strengths.

LESSON Marcus Buckingham found in [illegible] research that [illegible] managers [illegible] their time [illegible] their p[illegible] st[illegible]ns. Co[illegible]em

IMPORTING THE SAVIOR

Consultant RHR International says **companies go outside to fill 40% of CEO slots**—at a cost of $1 million to $3 million each. But newcomers have a 40% to 60% chance of failing in the first 18 months.

LESSON It takes effort, but **the best companies grow their talent in-house.** Hewitt Associates says 85% of leading companies tapped homegrown executives for CEO.

FOCUSING ON THE FAD

There is **no software you can buy off the shelf, no consulting guru who can jet in to solve all your recruiting and training needs.** But companies keep shelling out big bucks to find one, anyway.

LESSON Think about **what your company needs, drive hard toward that goal, and be patient.** Bellwether General Electric has been actively incubating leaders since at least the 1950s.

Chocolate is tempting, but sugar-free chocolate hasn't always had the same attraction. Candy companies knew there was a pent-up demand for better-tasting sugar-free chocolate and asked Cargill to help create it. We combined our expertise in sugar replacers with our knowledge and passion for making chocolate to develop a sugar-free chocolate that was superior to anything before. Now candy makers and other food companies are using it to create new products that are winning consumers and rapidly growing the market for sugar-free chocolate. This is how Cargill works with customers.

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HOW A DEALMAKER NURTURES NEWCOMERS

Johnson & Johnson

Johnson & Johnson is a highly acquisitive company. The drug giant has completed $30 billion worth of deals in the past 10 years. So when J&J bought Malvern (Pa.)-based Centocor Inc. in 1999, it was business as usual. At the time, the smaller company had a promising rheumatoid arthritis drug called Remicade. That product has turned out to be a blockbuster for J&J—as have many of the executives who came with the deal. Among them is Dr. Harlan Weisman, 53, now group chairman of pharmaceutical research and development at J&J, who had shown exceptional skill as a manager.

It's often hard to hold on to managers like Harlan in the aftermath of a takeover, but New Brunswick (N.J.)-based J&J has a good track record. That's a tribute to the company's broadly decentralized structure, which gives managers great leeway—no small thing for execs used to running their own shows.

J&J is also very good at providing ambitious managers with new challenges. At Centocor, for instance, Weisman specialized in so-called biotechnology protein therapies. They are typically administered by injection and known as "large-molecule" drugs. It's a far cry from J&J's bailiwick of small-molecule drug development, the traditional arena of pillmakers. But J&J didn't just leave Weisman in place. Soon after the merger, he began a two-year transition in which he learned the small-molecule business. Weisman now oversees more than 5,500 people and controls about $2 billion in R&D spending.

It's a system that's supposed to keep giving. As an executive, Weisman is rated not only on how well he develops talent but also on how well he does at exporting it to other J&J businesses. The second part is crucial. While many companies advocate job changes in order to develop talented execs, it's hard to convince managers that they should let their good people go.

Today, Harlan says the company's overall reputation for R&D has improved, and the number of molecules in the late stages of human testing has climbed from two in 2001 to 17, with Weisman's group supervising the development of many of them. "There is no better place to be," he says of J&J.

early June, is predicting sales will rise to $12.9 billion this year—70% of which will come outside North America—while earnings will climb 35%, to $1.67 billion. Schlumberger gets more of its revenue outside the U.S. than any of its rivals.

University alliances are just the start of Schlumberger's strategy. Once at the company, any engineer headed for the field goes through a three-year education program that combines classroom time with on-the-job projects. After an initial two to four months spent working on real jobs, field engineers come back to one of the company's 10 training centers, where they spend 12 weeks. The facility in Sugarland, Tex., ju[illegible]de Houston, is typical. On a recent afternoon, students sat in sm[illegible] classrooms. On one side of the hall, a Schlumberger engine[illegible] lectured a group of about a dozen. Across the corridor, oth[illegible] students sat at computers working on projects, many still in t[illegible] blue uniforms they wear on the campus' working oil ri[illegible] There's a strong bond formed within the groups. Years aft[illegible] their training, engineers say, they continue to keep up wi[illegible] classmates flung across the globe.

15%
of top companies hired their CEO from the outside

Data [illegible]

After 30 to 36 months, field engineers in North and Sou[illegible] America cap their training by spending two to three da[illegible] presenting a project that they have completed, somethi[illegible] designed to address a real business need. If they pass, th[illegible] are deemed promotable out of the field. Unlike many oth[illegible] companies, at Schlumberger strong performers from oth[illegible] disciplines often do a stint in human resources. It's seen as [illegible] gold star on a Schlumberger résumé, and 40% of its huma[illegible] resources staff are so-called visitors. Campus recruitin[illegible]

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NEW YORK LIFE

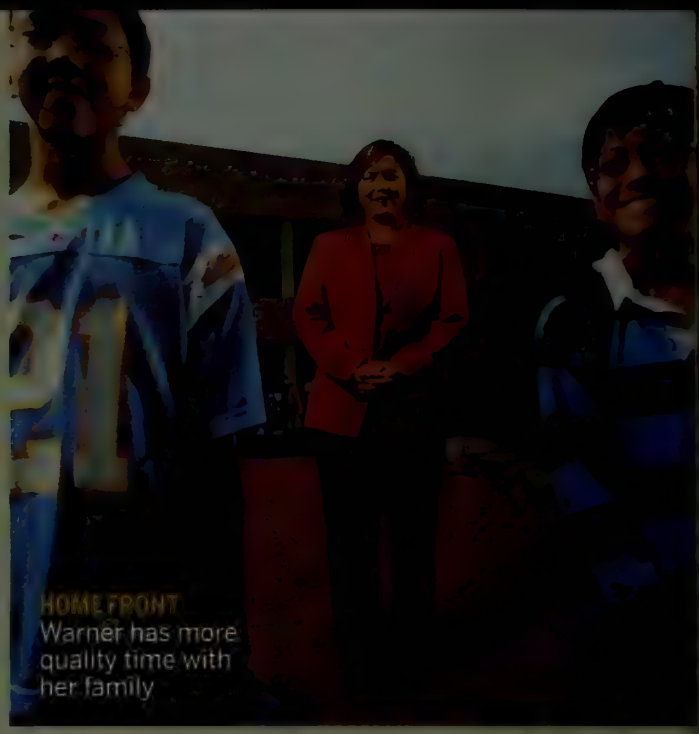
TREATING PART-TIMERS LIKE ROYALTY

Jefferson Wells

Liza Warner, 43, has the sort of résumé that recruiters at Big Four accounting firms drool over. Her specialty is internal auditing, a hot skill now that the Sarbanes-Oxley Act requires CEOs and CFOs to vouch for the strength of their internal financial systems. But instead of toiling at one of the accounting giants, she has chosen to work at relative unknown Jefferson Wells International—a firm that has gone out of its way to give valuable employees flexibility.

Warner spent the 1980s and first half of the '90s working at Bank One before joining fledgling financial outsourcer Jefferson Wells in 1996. She rose quickly. Six months after signing on she got her first promotion. In a year, she was managing a staff, and by spring of 1998, she was running the big Milwaukee office. But by 2002, Warner needed more time with her two young sons. She left the company—then discovered that she missed the stimulation of her career. "It was a shock," she recalls. When the company invited her back 10 months later with the promise of a 30-hour workweek, Warner jumped.

Of Jefferson Wells's 2,000 employees, 10% work a flexible schedule, with benefits, like Warner. A further 20% work even fewer hours, project by project, without benefits. The remaining 70% are full-time, but still have a lot more control over their lives than is typical at the Big Four firms many come from, where travel schedules are often grueling. How does the firm do it? Jefferson Wells is structured on a local-office model. Even when staff are stationed at their clients' offices, the offices are usually within driving distance of home. And unlike the Big Four, which work with the same clients for years, Jefferson Wells (now owned by Manpower Inc.) works on a contract basis, often on projects that last only a matter of months.



HOME FRONT
Warner has more quality time with her family

Although it can be complex to manage so many part-time staffers, there is a payoff: The company relies on its commitment to work-life balance to attract top-caliber candidates like Warner. Jefferson Wells will not hire anyone with less than seven years experience. People at that level are professional enough to get the job done without being baby-sat. "They probably get more out of me as a part-time employee than they did before," says Warner, whose schedule lets her put the boys on the school bus in the morning and greet them at the bus in the afternoon.

for example, is only open to "high-potential" staffers.

Some don't make it through Schlumberger's extensive training. "It's not lifetime employment guaranteed," says Cox. Of new engineers hired for the field, 40% will drop out before their third year is complete. Schlumberger's research and development group loses only 10% in that early period—but only one in four hires will make a full career at the company.

Not everyone is a fan of the system. Some former workers describe the company as "arrogant" and "insular" and its culture as "cliquish." Gould isn't surprised when he is asked about the characterization but counters that "any company that has an extremely strong culture has to live with those things." Daniel Guermeur, founder of Metadot, an open-source portal server, spent most of the 1990s working in technology at Schlumberger. He thinks that the company, which is still a client, is exceptional at recruiting globally and that it has maintained its technical edge. But he worries that there is less opportunity today for engineers to move up to top management than there once was, that as more MBAs move into the company, it's losing something. "People don't feel secure anymore," he says.

25% of the largest 500 companies are confident that their current talent pool is sufficient

Still, there are many examples of engineers moving up the ranks. Of Schlumberger top management, 80% started with the company right out of school, many as field engineers. And the chance to move up keeps people happy who might otherwise burn out. Bartz, who runs the Victoria wireline station, joined the company in 1995. An avid sea kayaker, camper, fly-fisher, and snowboarder, he spent most of his early career as a field engineer in Alaska. In his office, he keeps a book of photos of that time, including some of the polar bear that clambered out of the water and sauntered past his jeep. There is a series, too, of the truck that hauled his rig back to safety in far northern Canada after it got stuck in a frozen river and he and an intern spent two days north of cell-phone and satellite range.

For years Bartz wanted only to be in the field. But even for an outdoorsman like him, that life eventually grew wearing. So the flat plains of Texas replaced the tundra of Alaska. And while he once puzzled over extreme technical challenges, he now spends much of his time on personnel matters. If to an outsider it seems a major jump, inside the company it's seen as entirely normal. "People who are able to solve problems are going to do that in a lot of different roles and succeed," says Kenneth L. Havlinek, a longtime R&D engineer and now the technology manager for Schlumberger's Product Center. The company seems to have already solved the biggest problem of all: talent. ■

–With Amy Barrett in Philadelphia

DITED BY
DAM ASTON

NNOVATIONS

)f air taxis and Martian robots

Get ready to hail an air xi. The small Eclipse 500 vin-engine jet has passed its ext-to-last major hurdle to ll certification by the deral Aviation Administra-on. Eclipse Aviation, founded 1998 to launch a new era of n-demand travel with jets at can serve little airports, pects a final FAA thumbs-up ext March. The company now as orders for nearly 2,300 of $1.3 million Eclipse 500 anes, including a contract r 239 jets from startup ayJet, which plans to ot out Eclipse air taxis ext year.

NASA will roll out the xt-generation of Martian vers, K-9 (above) and omit, in early October at e Ames Research Center Silicon Valley. Following e success of Spirit and pportunity, two mobile bots still exploring the d Planet, the new models ll be both more self-liant and collaborative. proved artificial elligence should help the vers make navigation and her work decisions with ss assistance. Smarter AI uld also help the 'bots llaborate with humans on rth—or astronauts on ars—to explore, survey nding sites, or even help ild structures for human bitation.

POLLUTION

TO LIVE AND COUGH IN L.A.

HERE'S SOMETHING else to worry about: Air pollution may be increasing deadly health risks three times more than experts had thought.

Earlier studies looking at health and air pollution analyzed samples from several cities and correlated the findings with patterns in published health statistics. In a new study, published in the journal *Epidemiology*, a team of Canadian and U.S. researchers compared two decades' worth of data on air-particle pollution just within Los Angeles, then matched the findings with information on 22,905 Angelenos studied by the American Cancer Society from 1982 to 2000. After controlling for factors such as smoking and diet, they found that, for each increase of 10 micrograms of pollution per cubic meter of air, the risk of premature death from any cause rose 11% to 17%, compared with a 4% to 6% rise in the inter-city studies.

–Catherine Arnst

BIOTECH

A FRESH ASSAULT ON PARKINSON'S

LAST FALL, AMGEN abruptly halted tests on a Parkinson's disease treatment—a protein-based drug known as GDNF—because animal studies indicated it could cause permanent harm to humans. Now scientists at biotech startup Ceregene think they may have found an alternative: a growth factor called neuturin that is a first cousin of GDNF.

Ceregene researchers have begun a yearlong study of 12 advanced-stage Parkinson's patients at the University of California at San Francisco and Rush University Medical Center in Chicago. Each patient received four injections of a genetically modified virus designed to deliver therapeutic genes to the brain.

The researchers hope that the drug, developed at Washington University in St. Louis, will revive dopamine-producing nerve cells that are needed for smooth bodily movement but that are destroyed by the progressive, crippling illness. In earlier tests of neuturin on primates, tremors began diminishing within three months, says Jeffrey Ostrove, Ceregene's CEO.

–Michael Arndt

DIET

PARTICLES TO TRICK YOUR TUMMY INTO FEELING FULL

FORGET ATKINS and South Beach—the next big weight-loss craze might be "the Invisible Diet." Using nano-scale particles—about a billionth of a meter in size—researchers at Utah State University aim to trick the body into feeling sated by stimulating receptor proteins on cells in the small intestine. When stimulated, the cells send chemical signals to the brain indicating that fat has been ingested. But in some overweight people, these fat receptors may not be sensitive enough, causing them to eat more fatty foods.

The nano approach could cut willpower out of the diet equation. "People will be dieting, but they won't really be thinking 'I have to stop eating now,'" says Tim Gilbertson, the Utah State biology professor overseeing the study. His lab is working to identify a nanoscale drug that will target the fat receptors and speed up production of the missing chemical signals.

–Rod Kurtz

Hanging Up On Dell?

Gripes about tech support are on the rise, and the PC king is scrambling to upgrade

IT DIDN'T SEEM AS IF HE WAS asking for much. When the CD drive on Peter Ulyatt's Dell desktop computer failed this summer, he called the support crew at Dell, where he'd bought the $1,600 machine nine months prior. Armed with an extended warranty that cost him an extra $300, the Pasadena (Calif.) retiree got on the phone and waited. After sitting on hold for 45 minutes, a technician whom Ulyatt could barely understand came on the line and diagnosed a "software problem." Ulyatt's call, transferred to the software technician, was dropped. Calling back, Ulyatt waited on hold another 45 minutes, asked for the software desk, and waited a half-hour more before hanging up. "At the moment, I'm not high on Dell's service," says Ulyatt, who plans to buy two new PCs in a year or so. "When I buy again, I will look at others beyond Dell."

Ulyatt's ordeal is not an isolated case. All tech companies have some unhappy customers, of course, but recent surveys suggest the ranks of frustrated Dell Inc. owners are growing. Complaints to the Better Business Bureau rose 23% in 2004 from the year before, and they're up another 5% this year. And Dell's customer-satisfaction rating fell 6.3%, to a score of 74, in a survey by the University of Michigan. Dell's score puts it right at the PC industry's average for the study, in which Apple Computer Inc. led the way with an 81. Still, it's a big decline, especially for a company that has often topped the list. "We've never seen a drop like this," says professor Claes Fornell, who ran the survey.

Plenty of people are going public with complaints. Media critic Jeff Jarvis has recounted his frustrations on his blog. Web sites such as ihatedell.net have popped up. Helaina Burton recently spent three hours talking to a half-dozen Dell reps—all to solve the simple problem of a faulty keyboard. "I certainly won't buy another product from Dell," she says. "I will make sure that any other prospective Dell customer I meet knows what kind of treatment they'll get."

Could such sentiment lead to trouble for the world's largest PC company? Over the past decade, Dell's dependable support, combined with competitive prices and build-to-order convenience, made it the default choice for millions of consumers. Its market share continues to rise overall, and it holds 28.8% of the U.S. consumer market, up from 28.2% a year ago, according to researcher IDC. However, a sagging reputation could slow sales, jeopardizing the company's plan to reach $80 billion in revenues by 2008. In the most recent quarter, Dell missed its sales target, one reason its stock has dropped 18%, to $34, since the start of the year.

MORE REPS

DELL IS WORKING to reverse the service slide. John Hamlin, senior vice-president of Dell's U.S. consumer business, says the company is hiring a few thousand additional reps this year and striving to reduce call transfers. Already, he says, hold times have been cut in half from earlier this year, and internal weekly surveys of 5,000 customers show a 35% increase in customer satisfaction from a year ago.

Now the company, which revolutionized how PCs are sold with its direct model, has plans to change how PC support is provided. On Sept. 28 it announced a line of higher-priced PCs, dubbed the XPS line, that will come with improved levels of service. XPS owners who call in for help will be routed onto shorter queues to dedicated teams made up of the company's "best" phone reps, says Michael A. George, general manager of Dell's U.S. consumer businesses. "The goal is for the vast majority [of XPS owners] to wait for less than five minutes."

That's one of several ways in which Dell will encourage customers who want more support to pay extra for it. In November the company will launch a slate of new offerings, including remote assistance so technicians can take control of the customer's PC to fix problems. And early next year Dell will introduce a series of one-year mem-

How Dell Stacks Up

The company saw customer satisfaction ratings tumble over the past year

COMPANY	2004	2005	%CHANGE
APPLE	81	81	0%
HP (HP BRAND)	71	74	+2.8%
DELL	79	74	-6.3%
GATEWAY	74	72	-2.7%
HP (COMPAQ BRAND)	69	67	-2.9%
ALL OTHERS	71	74	+4.2%
INDUSTRY AVERAGE	74	74	0%

University of Michigan

Avoiding PC-Induced Headaches

Poor service is all too common in the industry. Here are some tips for minimizing the pain:

CONSIDER APPLE
It's a perennial leader in customer service surveys. One big reason is there are fewer viruses and less spyware for the Mac. Apple's fatter gross margins mean it can invest more to serve its 5% corner of the PC market.

BE CAUTIOUS
Use and update antivirus and spyware-protection programs. They'll keep most nasty things off your machine. And don't forget to backup photos and other files frequently.

GET THE WARRANTY
Buying an extended warranty for your toaster may be a waste. Not so for a glitch-prone product like a PC. You'll even get quicker help on customer-service lines in some instances from companies such as Dell.

rships so customers can opt for vari-s levels of help, at various prices. One the options will likely include a quar-ly PC tune-up, in which a techie would notely clean up the hard drive and eck security settings.

All of this adds up to a quiet attempt to et customer expectations in the PC in-stry. While execs won't say so licly, the message is clear: at new PC you bring home nes with only the most rudi-ntary support. More hand-ding costs extra.

Indeed, Dell is rolling back ne of the perks that now ne standard. *BusinessWeek* s learned that in mid-Octo-, Dell plans to redefine the n "free shipping" for its -end models. Instead of de-ering them to the customer's me, Dell will mail them to the nearest t office for pickup. These customers e to pay extra for home delivery—al-ugh it comes standard with pricier dels such as the new XPS line.

It's tough medicine that fits with Dell's gmatic approach to business. The npany is the No. 1 player in the U.S. sumer PC market. But sales to U.S. sumers carry margins of 6%—compared with 11% for corporate buyers. The new "pay-up" strategy could help make sure the consumer unit doesn't eventually become a drag on earnings.

Some industry experts think Dell's plans are simply a practical response to plummeting prices. "Consumers want to have their cake and eat it, too. They want that $300 PC but expect the same support that came with a machine that 10 years ago cost $2,500," says Stephen Dukker, who founded home PC maker emachines Inc. in 1998.

Dell plans to start charging for better levels of service

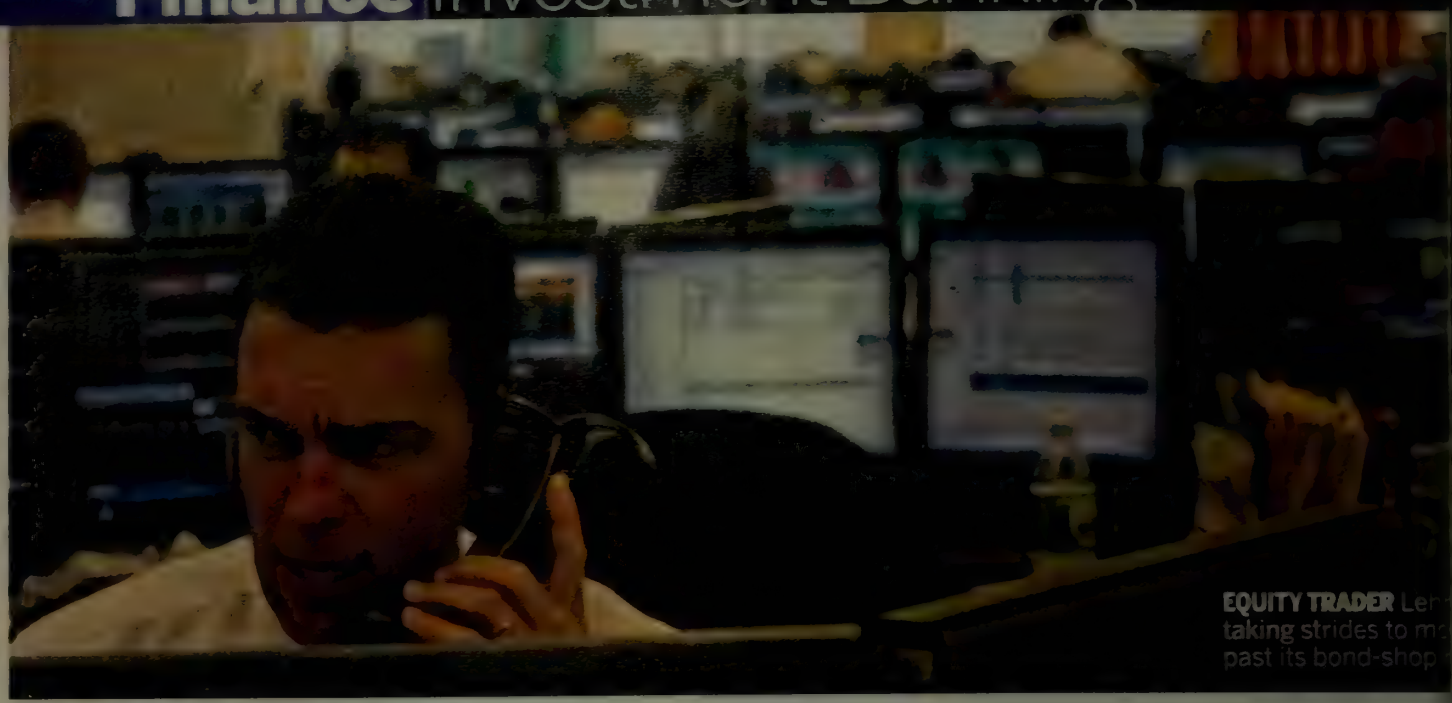
Other key PC makers are increasing the pressure on Dell. Apple, which consistently ranks high in customer surveys like Michigan's, recently decided to start using chips from Intel Corp., making it a more direct competitor to Dell. And Hewlett-Packard Co., Dell's biggest competitor, seems intent on distinguishing itself with customer service.

Over the past year, HP has launched several initiatives to build loyalty. One lets HP employees key in information on product glitches they hear about from customers, who then are supposed to receive a call from a rep within 48 hours. Another is a diagnostic tool HP developed to help consumers figure out what kind of problem they have, even if it doesn't involve HP gear. Dell won't help customers with non-Dell problems unless they pay extra. "Given today's digital lifestyle, it's vital," says Diana L. Bell, HP's senior vice-president of total customer experience. "We have to do more than say, 'here's the product, and catch me if you can.'"

A common refrain from Dell customers is that the company seems to want to hide from them rather than help them. Edward Huebner, a Detroit sales manager, called Dell to ask about upgrading the software on a Dell DJ music player. He couldn't get the assistance he wanted on the phone, so he tried Dell's online chat service. But there were delays of as long as five minutes between responses. Huebner gave up and tracked down an answer on an online message board. Afterward he posted this parting salvo: "You've lost a customer for life." A Dell spokeswoman says a five-minute wait is "outside the norm."

Huebner's experience may be a warning sign. If customers don't go for the new "pay-up" plans and service keeps sliding, Dell may have to put more money into solving the problem itself—or risk having more consumers defect to rivals. ■

–By Louise Lee in San Mateo, Calif., with Emily Thornton in New York



EQUITY TRADER Leh taking strides to ma past its bond-shop

A Bank In Bondage

Lehman's growth astounds, but its fixed-income fixation may tie it down

LEHMAN BROTHERS INC.'s third-quarter earnings took Wall Street's breath away. The 74% surge in net income, on a 47% jump in revenues, trounced the estimates of analysts, who declared that Lehman's "exceptional" performance "knocked the lights out." The bank's shares were already riding high: The stock's 34% rise so far this year is twice that of its peers, and its price-to-book ratio rivals that of premier player Goldman, Sachs & Co. In fact, the 155-year-old Lehman, long dismissed as merely a bond shop, increasingly finds itself mentioned alongside Goldman as a member of investment banking's "bulge bracket."

But is Lehman really ready for this elite club? Despite its recent moves to grow and diversify, the bank still has some no table voids in its business mix and global presence that it must fill to play in the top ranks. The biggest weakness: Lehman still gets 58% of its revenue—and, analysts say, 70% of pretax profits—from issuing and trading bonds. That's down from 63% of revenues in the prior quarter, but it still leaves Lehman as the Wall Street firm most dependent on fixed-income business. Investors are calling for bold moves to expand the equity side of the ledger. "I still see a Lehman that is more dependent on mortgage and credit trading," says managing director Jeff Harte of Sandler O'Neill & Partners LLP, who downgraded Lehman's shares from "buy" to "hold" just before its robust earnings news.

The five-year bull run in bonds was good to Lehman. But now the bank could be vulnerable if rising interest rates scotch debt issuance and trading. "If credit spreads and bond volatility get to a more normal leve Lehman could see very little earning growth next year," says analyst Micha Hecht of Banc of America Securities. I deed, one of Lehman's bond-business r vals, Bear Stearns & Co., saw its shar sell off after it announced a slip in fixe income revenue on Sept 15.

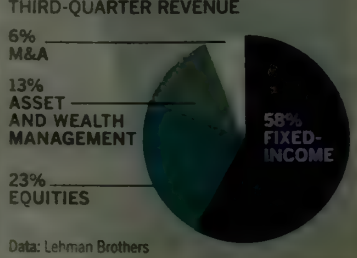
Recognizing the risks, Lehman took a vantage of Wall Street's doldrums to hi bankers and make acquisitions, such the 2003 purchase of mutual-fund ma ager Neuberger Berman LLC. Its wor force has grown 68% since 2001. "They' had the guts to expand their footprint and it really did pay off," says Merr Lynch & Co. analyst Guy Moszkows Lehman's beefed-up banking team had hand in such recent megamergers Sprint's takeover of Nextel and Chevr Corp.'s successful quest for Unocal. Th clout has paid off in other ways: Equit capital markets revenue doubled, to $63 million, in the latest period.

But Lehman is playing catch-up—e pecially in equity prime brokerage, whic caters to the exploding hedge-fund i dustry. While Gol man, Morgan Stanle and Bear Stearns a brokers of first choi for the biggest fun and institutions, Leh man remains a fallbac option. "We were a li tle late to the class," a mits Chief Administr tive Officer Da Goldfarb. Hecht puts more bluntly: "Th are nowhere near t top players."

UNFINISHED BUSINESS

Lehman still relies far too much on its bond business

THIRD-QUARTER REVENUE



Data: Lehman Brothers

.ehman also comes up short in Asia. e firm captured less than 1% of the an-Pacific investment-banking mar- last year, ranking Lehman a dismal d in debt underwriting and 17th in ity underwriting, according to alogic. And it has just 25 bankers in na, where the likes of Citigroup and S dominate.

JING BEACHHEADS

ALYST MOSZKOWSKI estimates t Asia will produce a third of Wall eet's revenue growth during the t decade. But the barriers to entry high, as Lehman learned when its ent aggressive push to fund a adcasting deal prompted an outcry n Japan's politicians and news me- China is even trickier: Morgan nley and Goldman spent years blishing beachheads for their bro- s, traders, and bankers. Lehman's na campaign has been far less am- ous. "Our strategy has been viewing na primarily as an investment- king opportunity," says Goldfarb, ing that the firm has a "relatively n" group of bankers in China. e're constantly evaluating the scal- and sizing of our effort there."

ome investors want to see more. es Ellman of Seacliff Capital, a San ncisco financial-services hedge fund owns Lehman shares, is keen to see man enter a joint venture with an blished Chinese investment bank. t, he argues, would give Lehman en- to privatization deals and the con- ing expansion of China's equity kets. Following the Neuberger man purchase—which helped cata- Lehman's assets under manage- nt from $9 billion in 2002 to nearly 0 billion today—Ellman favors ac- ring overseas asset managers. At ne, he wants the firm to get aggres- ly in front of "megasize" prime-bro- ge clients. "Almost anything that ld reduce Lehman's fixed-income osure would impress the Street," s Ellman.

Goldfarb says Lehman won't be ned. "We're not going to compro- e our superior economics to do an uisition for the sake of acquisition," says. Given Lehman's strength in erging from a brutal market shake- the firm's managers earned the t to follow their own course. But to in the bulge bracket, Lehman still some growing to do. ■

—By Roben Farzad in New York, with Brian Bremner in Hong Kong

GETTY He put in the first $10 million; now he's seeking outside investors

How Gordon Getty Got to 'Aha!'

His idea: A startup that offers funds fast cash to cover shareholder redemptions

GORDON P. GETTY DEscribes himself as a man from another era. "I am two-thirds a 19th-century composer," says the 72-year old son of oil tycoon J. Paul Getty. He idolizes Schubert, Beethoven, and Wagner and composes waltzes, chamber works, and oratorios in his ample spare time.

But the other third of the shag-topped billionaire appears to be something else altogether: a 21st-century entrepreneur. In 1997—around the time he wrote the verse for *Young America*, a piece for chorus and orchestra—Getty went on safari in Africa and had a revelation about how to provide mutual-fund managers ready cash when shareholders stampede out of a fund. "It just sort of came to me," he says. By the end of 2001—after working nights to compose the music for *Young America* and days turning his mutual-fund idea into a startup called ReFlow Management Co.—Getty was ready to roll out both productions.

Since then, ReFlow has been much slower to catch on than *Young America*, which was released on CD in July and has been performed by the San Francisco Symphony. The notoriously cautious

mutual-fund industry has been reluctant to embrace ReFlow's service. Nevertheless, Getty remains committed to it. This fall the company, which is based in San Francisco's financial district and counts about 30 employees, will attempt to raise its first pool of capital from outside investors; so far it has been financed with $10 million from his own pocket. The new money, which might total $250 million, would be tapped by mutual funds that need quick cash when shareholders bail out.

Getty aims to help mutual funds with a perennial problem: how to cover redemptions without borrowing from a bank or selling off assets and paying the commissions and capital-gains taxes—both costly solutions that erode returns. Roger M. Edelen, a former Wharton School professor and a consultant to ReFlow, estimates that Wall Street pockets $30 billion a year in commissions from mutual funds that need to sell assets to pay departing investors. "ReFlow comes along and says: 'We'll do that for $5 billion a year'—an 80% reduction, because you don't have to trade the underlying assets," he says.

ReFlow's solution is to buy shares in the mutual fund so the fund can raise money, charging 0.15% of each transaction and sparing the fund the taxes and commissions. When the fund receives buy orders, it repurchases shares from ReFlow; after 28 days it buys back any shares ReFlow still holds. The company makes its money on the fees and plans to make average market returns on the shares. But this model has yet to be tested in a broad market plunge.

For all this to work, the company needs lots of customers, but so far business has been scarce. ReFlow's largest client is Forward Funds, a San Francisco firm with $1.1 billion under management that Getty started in 1998; he's still the largest shareholder. A handful of other mutual-fund companies have signed up, but they have only nibbled at the service, says ReFlow. Finding the kinds of funds that need ReFlow the most is one of the start-up's biggest challenges. Likely beneficiaries include small stock funds with out-of-favor investment styles. These smaller outfits tend to keep a limited reserve of cash and are prone to big sell-offs by shareholders. But no matter what a fund's profile, it's likely to resist change—at least until it sees other mutual funds using ReFlow.

Taking a chance with ReFlow may require an open and inquisitive mind much like Getty's. Colleagues marvel at his curiosity and penchant for self-instruction. When Getty first got interested in mutual funds in the early 1990s, he wrote a paper for the Brookings Institution in which he argued that inflation could be licked by replacing national currencies with mutual funds. The idea drew interest from several academics, including Nobel economics laureate Franco Modigliani. A more recent example: When he was setting up ReFlow, Getty couldn't find a computer programmer to write a program he wanted in Java. So he taught himself the language over the weekend and showed up on Monday with a rudimentary version of the program.

1984 "I'm two-thirds a 19th-century composer"

Getty has often been described as an absent-minded professor. Asked if his wide-ranging skills stem from a common personality trait, he says: "I can't find a connection" among them. As a young man his business acumen was sometimes in question—until he oversaw the 1984 sale of Getty Oil. As the largest shareholder, he agreed to sell the company to Pennzoil. But before the documents were signed, Texaco made a better offer, $10.1 billion, which Getty took, showing he could be as nimble-minded as he was contemplative. "When a crisis happens in business, it gets my attention," he says. Today his net worth is put at $2.2 billion.

Getty's personal life has been marked by unconventionality, too. In 1999 he publicly acknowledged that for more than a decade he had secretly kept a second family in Los Angeles consisting of three daughters and their mother. The Getty family appeared to take the incident in stride, and Getty remains married to his wife of 41 years, Ann.

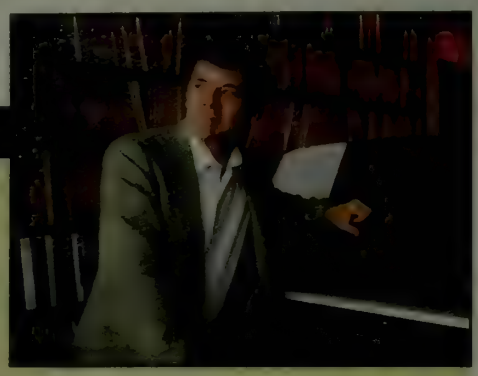
Getty's ideas may be interesting, but whether they work in practice is far from guaranteed, especially when changes in human behavior are required. Compelling as ReFlow may be, it could take years for it to catch on—if it ever does. But the same was true of mutual funds, index funds, and money-market funds when they were introduced. The more novel the idea, the harder it is to sell. ■

–By Justin Hibbard in San Francisco

BIO

Gordon P. Getty

His vast wealth has allowed him to pursue interests as varied as music and mutual funds



BORN Dec. 20, 1933, in Los Angeles. Son of oil tycoon J. Paul Getty and his fourth wife, Ann Rork.

EDUCATION B.A., English literature, University of San Francisco. Studied music theory at the San Francisco Conservatory of Music.

JUNE, 1973 With his wife Ann in England

JOBS Chairman of ReFlow Management. Largest shareholder of mutual-fund company Forward Funds. Co-owner of PlumpJack Group winery and restaurants. Director of the Ann & Gordon Getty Foundation.

MUSICAL CAREER Honored as an Outstanding American Composer at the John F. Kennedy Center in Washington in 1986. Compositions include *Plump Jack*, an opera based on Shakespeare's Falstaff.

POLITICS Contributes largely to Democratic candidates. Recently hosted a fund-raiser for New York Attorney General Eliot Spitzer, a Democratic hopeful for New York governor, at his home in San Francisco's Pacific Heights.

INTERESTS Archeology, economics, computer programming, the San Francisco Giants.

FAMILY Married to Ann Getty, with whom he has four sons. In 1999 acknowledged a second family, with three daughters, in Los Angeles.

BusinessWeek online For a Q&A with Gordon Getty, go to www.businessweek.com/extras

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GAMEBOY

Can **Johnathan "Fatal1ty" Wendel** win credibility for pro gaming—and for himself? **By Steve Hamm**

ROCK MUSIC BLARES. SPOTLIGHTS SLICE THROUGH THE AIR. *Young men in black T-shirts chatter excitedly. It's Sept. 3, Sheffield, Britain. The Cyberathlete Professional League tournament has taken over a sprawling former steel mill in this city north of London. One competitor stands out: Johnathan "Fatal1ty" Wendel. He clamps a headset into his ears, using the techno music to isolate himself from the crowd. The tall, blond 24-year-old is America's most successful gamer, and here he's all business. He's determined to take down archrival Sander "Vo0" Kaasjager, a 20-year-old Dutchman who has dominated the CPL all year. Wendel trounced Kaasjager in the previous tournament, in Dallas, in July, and he means to do it again.*

Before he gets to Kaasjager, though, Wendel will face off against Alexander "Ztrider" Ingarv. The 18-year-old Swede finished third in Dallas and is always a threat. Wendel takes his position at a PC on one of a string of tables lined up along a wall—with Ingarv sitting a few chairs away. On their screens: the interior of a gloomy castle where their two characters will pursue each other at dizzying speeds through a labyrinth of rooms and blast away when they make contact. The game is Painkiller, *and in this tournament version, the characters are "brightskins"—red silhouettes of men that stand out as targets. The player who kills his opponent the most times in 15 minutes is the winner. It's a best-of-three match.*

Ingarv gets off to a fast start. He fires away and gets a couple of quick kills. A few minutes into the match, Wendel starts clawing back. He has a knack for counting the seconds until a weapon, ammo, or armor will materialize at a particular spot in the maze and being there to claim it. Cheers and jeers [illegible] as Wendel takes the lead. When time runs out, he wins in a [illegible]er, 16 to 15. The second game is no contest: After fi[illegible] Ingarv is shaking his head dejectedly. As the thras[illegible] more one-sided, a small crowd that had gathered around Wen[illegible] grows quiet. The final game's score: 31 to 7.

What's all the hubbub about? Unbeknownst to almost eve[illegible] one over 30, professional game playing is becoming a very l[illegible] deal. There are worldwide tours with stops from Rio de Jane[illegible] to Istanbul. Celebrity players are hounded for autographs a[illegible] compete for high-stakes prizes. At the CPL World Tour Gra[illegible] Finals in New York in November, players will compete fo[illegible] total of $500,000 in cash.

Cyberspace **Statesman**

IN THIS NEW WORLD, Johnathan Wendel is the undisputed st[illegible] Over a period of five years, he has won more tournaments a[illegible] pulled in more prize money than any other player, a total that h[illegible] now topped $350,000. Girl gamers buzz about him at match[illegible] like a group of Swedish players in Barcelona this summer. A[illegible] boys idolize him. "He's so good," says Iisakki "Beam" Ahonen, [illegible] up-and-coming 17-year-old Finn player. "I want to be like him [illegible] to travel and compete in tournaments and make a living at it."

Yet Wendel is doing far more than just winning tournamen[illegible] He has become one of the key figures in popularizing comput[illegible] games throughout the world. With his success and clean-c[illegible] good looks, he plays the role of statesman for his sport, the Tig[illegible] Woods or Michael Jordan of cyberspace. He aspires to help tu[illegible] a niche phenomenon into a popular sport watched by millions [illegible] fans on TV and the Internet. "I want to bring gaming mai[illegible] stream," Wendel says.

EMENT
digitally
into the
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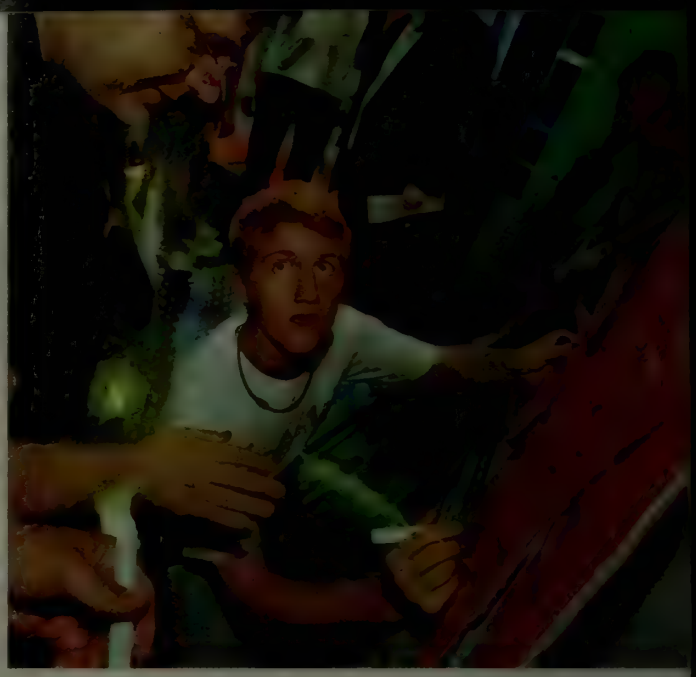
If Wendel's hand-eye coordination is admirable, his market timing may be even better. Electronic gaming is exploding and spreading everywhere—from consoles and PCs to online communities and cell phones. More than 300 million people play worldwide, fueling an industry that is expected to rake in $34 billion in revenues this year, according to market researcher DFC Intelligence. Worldwide box-office receipts for movies, in comparison, were $21.4 billion last year.

That has pro gaming at the tipping point. Webcasts of the tournaments have grown increasingly popular, with 25 being shown this year, up from two in 2000. Traditional TV producers are getting on board. ESPN in November plans on broadcasting an eight-part documentary about a team that plays the game *John Madden NFL Football*. MTV Networks will cover action from the CPL finals in New York. And HDNet, the high-definition TV network, is scoping out tournament coverage. "Watching the teams go at it, the battles are incredibly competitive," says Mark Cuban, co-founder of HDNet and owner of the NBA's Dallas Mavericks.

Wendel may be just the sort of bona fide superstar to push gaming over the top. He's 6 feet tall, slim, and athletic. "The gamer image is out-of-shape, pasty, nerdy, smelly," says Roger L. Kay, president of tech market research outfit Endpoint Technologies Associates. "This guy can promote the industry as a cool place to be."

But Johnathan Wendel's a different sort of star than Tiger or Michael. His game takes place in another dimension: the emerging realm of cyberspace. In a sense, he's a guide to the future. For his generation, the Internet is the sandlot baseball diamond, Main Street, and the neighborhood cinema all rolled into one. Online, they play games, instant message, and share their lives with people halfway around the world.

To win them over, media and entertainment businesses have to learn to play by new rules. And to market to this key demographic, companies from Ford Motor Co. to Procter & Gamble Co. have to get with it, too. They all need to recognize that the Web is evolving into a global forum for sport, communications, and entertainment. cyberspace, Wendel is as much Tom Cruise as Tiger Woods. "T ditional businesses need to plug in," says Saul J. Berman, a co sultant in IBM's entertainment industry practice. "This is t consumer base of the future. Somebody who doesn't understa this stuff won't be able to spot the opportunities and the threat



FANS WORLDWIDE Wendel signs autographs in Antwerp, Belgiu

Certainly, many companies are begi ning to see opportunity in gaming. Ne Corp., for instance, just paid $650 milli for game-site operator IGN Entertai ment Inc. (page 34). Big-name tech co panies Intel Corp. and Samsung Gro are putting up the prize money for ma of the tournaments worldwide. Th hope to benefit from the halo effect of b ing associated with the coolest, fast gamers and sell more high-end gear. T average desktop PC price is about $8 compared to $3,000 for a jazzed- gamer PC. But interest in gaming go well beyond techies. Consumer-produ companies are sponsoring gamers, to Tylenol backs Team Ouch!

The biggest pri may go to Wend himself. He's worki to establish a worl wide brand, som thing no gamer h ever done. He's licen ing the Fatal1ty nan (pronounced simp "fatality") to seve hardware makers a expects to come out with a Fatal1ty soon. Down the line, he'll introduce ha clothing, and even static-resistant shoe "He's beyond games. He's the spok

THE BUSINESS OF E-SPORTS

The electronic games industry has been booming in recent years. Now professional gaming is taking off.

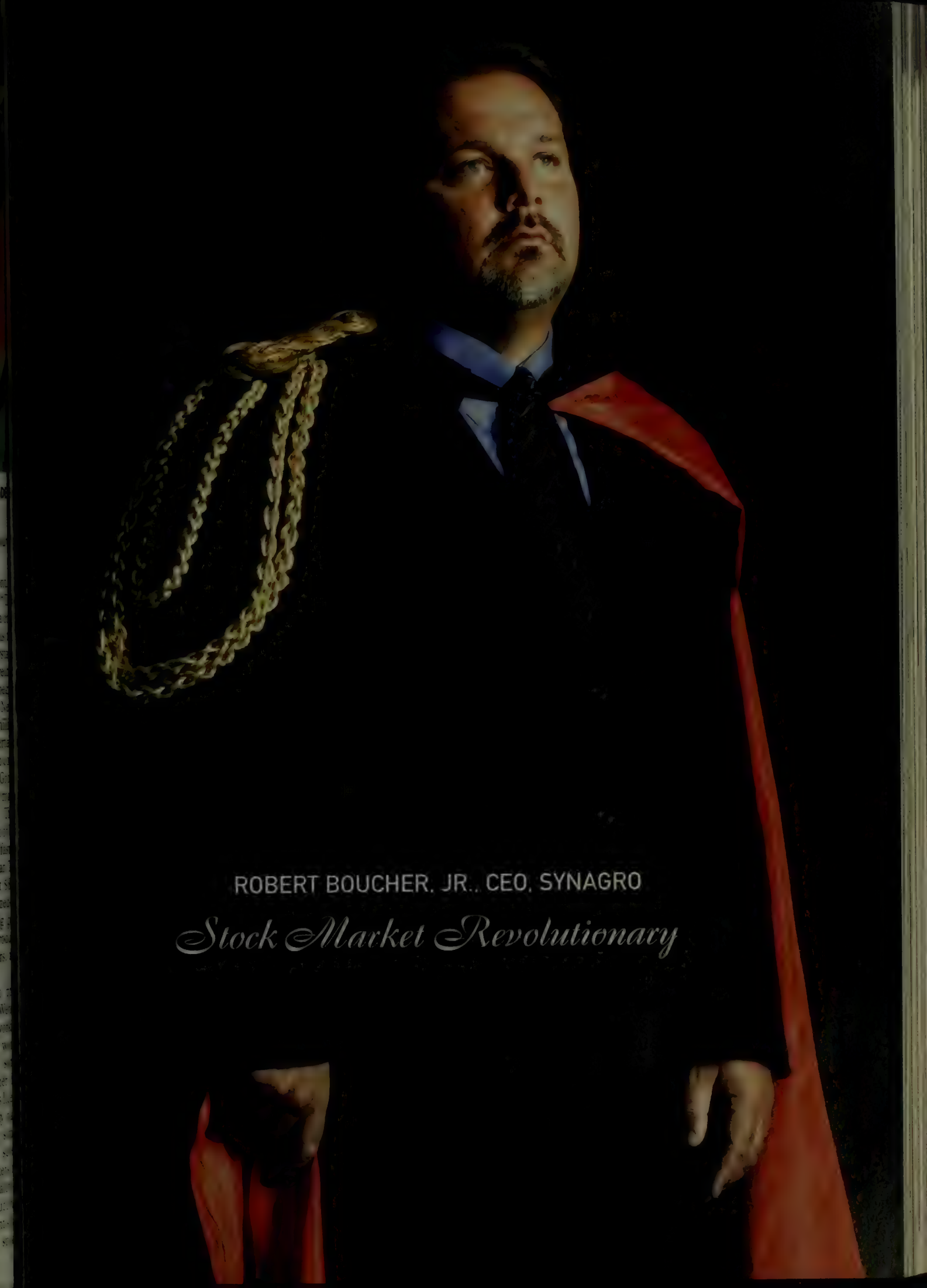
TOURNAMENTS: The first Cyberathlete Professional League competition, in 1997, was a low-key event, held in the back of a Dallas office building. Winners took home a total of $4,000 in prizes. Now tournaments have become glitzy, high-stakes affairs. The CPL will hold its finals this November in New York City and hand out $500,000 in prize money.

SPONSORSHIPS: Big-name companies are getting into the gamer field by sponsoring tournaments, professional teams, and even individual gamers. Chip-giant Intel is the primary sponsor for the CPL 11-event world tour. Other backers include Samsung, AMD, and Tylenol.

GAMER PRODUCTS: Gamer gear is one of the more lucrative and fast-growing segments of the computer industry. The average gamer PC sells for $3,000, compared with $800 for a standard PC. Pros and enthusiastic amateurs want high-performance keyboards, mice, and accelerator cards, and they're willing to pay extra for them.

BROADCASTING: The professional tournaments are becoming big fan events. Team Sportscast Network streams live action over the Web, with frenetic play-by-play commentary from "shoutcasters." TSN will cover 25 tournaments this year, up from 2 in 2000, its first year in the business. Now, MTV plans to televise segments of the CPL championship in November.

FATAL1TY MOUSE Designed with Creative Labs


ROBERT BOUCHER, JR., CEO, SYNAGRO
Stock Market Revolutionary

person for the digital revolution," says Mark Walden, director of licensing at Auravision Inc. in Woodland Hills, Calif., Wendel's master licenser.

Fatal1ty's **Lair**

YET FOR WENDEL, THIS QUEST is about much more than building his own business. Strip away all the trappings, and what he's doing is shooting for respect. As a hard-core gamer, he's a member of a clan of outcasts—the people who didn't quite fit in. Now the crazy tech stuff they're good at is cool. So Wendel is out to prove that PC gaming is legit—not only to the world but also to his own mother. After his parents divorced when he was 13, his mother cracked down on his game playing. They fought so bitterly that he left home for good on the eve of his high school graduation. "This is about proving her wrong," Wendel says. "She never believed in me. The day I drive up in front of her door in a Ferrari is the day I close the door on that subject."

But if Wendel is to achieve his goals, he has to keep winning, and this has been a tough year. Wendel placed fourth and sixth in early tilts before rising to second and, finally, taking first place in July. The pressure is on for him to win the CPL championship in New York. "You've got to win. You can't just be around, not winning. Young kids want to emulate the best of the best of the best," says Mike Antinoro, executive producer of ESPN Original Entertainment, creator of the *Madden* series.

Back in Sheffield, it's the last day of the three-day tourney. Fatal1ty and VoO breezed through the preliminaries. Now, they're playing each other. The one who wins this best-of-three match will go straight to the finals, while the other one will have to fight through other contenders to earn a spot.

The two don't make eye contact before the bout. Wendel settles down at a PC at one end of the string of tables. Kaasjager is sitting a few seats away but out of sight. In the first game of the match, Fatal1ty easily beats VoO, 32 to 12. He studies his opponents to anticipate their moves, and he mixes up his own style so he's unpredictable.

The second game is a nail-biter. They trade kill for kill. Kaasjager yells at the screen in Dutch. Wendel is mum until the end. When he wins by a point, 16 to 15, he yells "Yeah!" and pumps his fist before threading th the crowd and perfunctorily shaking Kaasjagers's hand. "Th awesome," he says. "That was the biggest match, right ther

Victories like that don't come easy. When Wendel first t pro, back in 1999, there were only a handful of worthy nents. Now there are two dozen elite players. To stay on his game, he practices tirelessly. Between tournament ap ances and promotional "Fatal1ty Shootouts" at trade s he'll duck out for a few hours and practice in his hotel roo even has a sparring partner whom he takes on the road— "Zen" Grapatin, a 23-year-old former club tennis pro.

But Wendel truly gets into the practice groove only whe at home in Kansas City, Mo. He rents a basement roon modest ranch house off I-435. Roommate and longtime f Jarod Reisin makes his living as a valet parking attendan local nightspot. Some of the decor is from the 1960s, with ty pine paneling in the room, and, in the kit turquoise kitchen counte and mint-condition pl covered chairs. But most furnishings are pure '90s cushy couches clus around a 5-foot TV, surro sound speakers, and poste Bruce Lee and *Star Wars* on the walls. When a rep visited, Wendel whipped u favorite snack, a dip of gr beef and melted Velveeta.

The basement is Fata virtual workout gym. It's a dark room crowded with a waterbed, the headboard with gleaming trophies gamer memorabilia. In one ner there's a boxy *M Kombat* arcade game. This Wendel's first love. He too gamer handle from the that flashes on the screen a end of a *Mortal Kombat* con Fatality! Four PCs are set u tables and connected via a work. When Wendel is h the day goes like this: U noon, game, eat, run miles, game, game some watch a movie, snack, g even more, and turn in at a 4 a.m. Altogether, he prac eight hours a day.

It's not easy being Fatal sparring partner. "When started last year, I'd win 40 the time. Now it's 10%," Grapatin. "It's gotten to point where I have tro playing with him. He's whole other level." Fata brings in new players to c pete with—and to give Ze break. In August, he sent

A GAMER GLOSSARY

Computer game enthusiasts inhabit a unique subculture with its own slang. Here are some of the key terms:

FRAG To shoot another character in an action game until they're blown to bits and die.

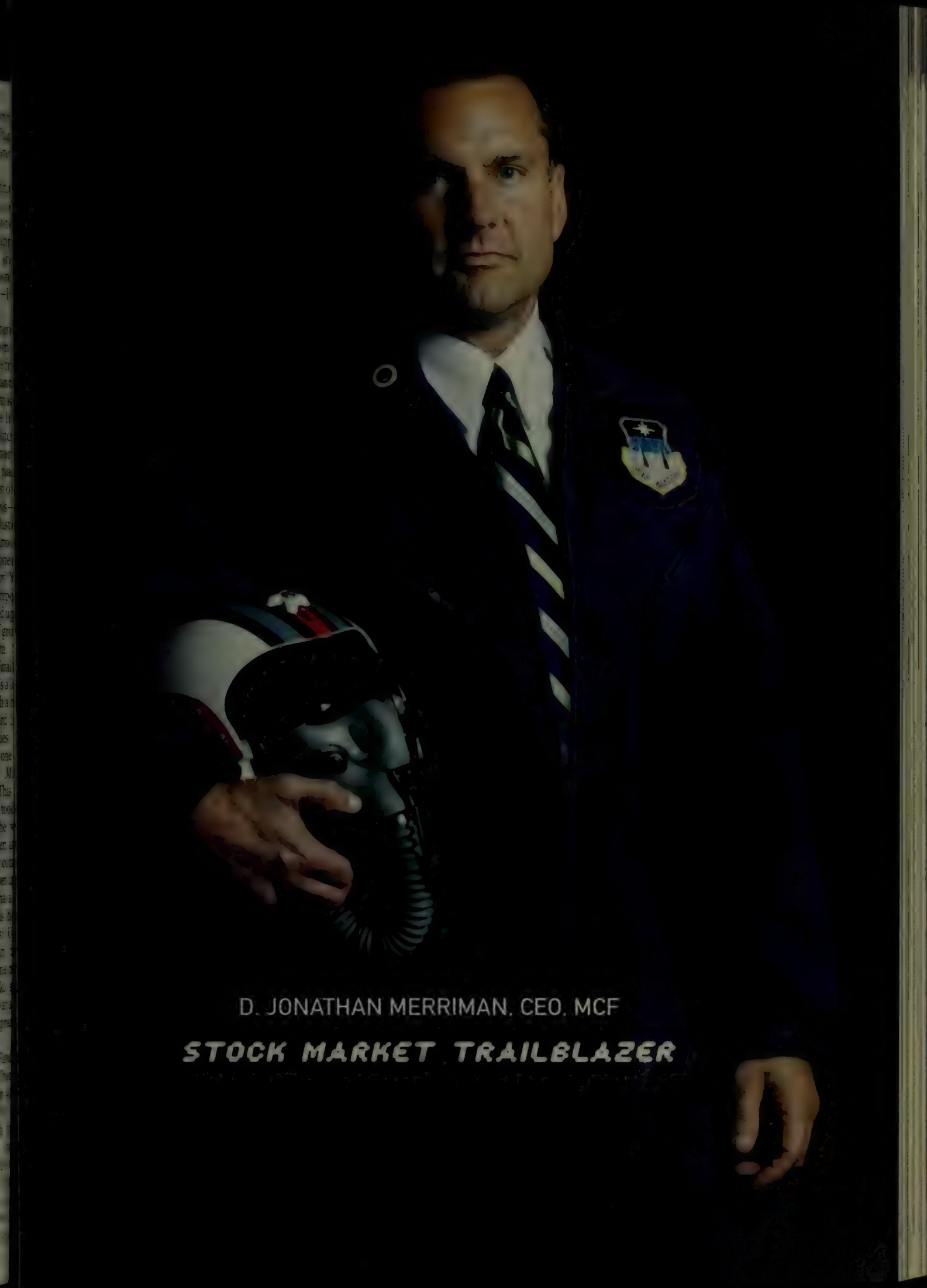
HARD-CORE GAMER Person whose principal leisure pastime is playing electronic games.

LAN PARTY A gathering, often in a home or hotel conference room, where enthusiasts play competitive games via a local-area network or Net connections.

MODDING The practice among hard-core gamers of putting special see-through cases on their computers, lighting the interiors, and buying special circuit boards to improve response time and graphics.

MULTIPLAYER GAMES Games played on local-area networks or across the Internet that involve anywhere from two to hundreds of players.

OVERCLOCKING Changing the configuration of a PC processor to make games run faster. This often requires adding a special cooling system so the processor doesn't burn out.



D. JONATHAN MERRIMAN, CEO, MCF

STOCK MARKET TRAILBLAZER

tickets to Kansas City to two gamers in Texas and Minnesota.

Late one night at Wendel's, Fatal1ty knocks the stuffing out of Zen in *Painkiller*. He stares intently at the computer screen as his character moves rapidly through the game set. His right hand, holding the mouse, sways gracefully from side to side. Suddenly, a red silhouette of a man hops out of nowhere and Fatal1ty blasts away, the fingers of his left hand tap dancing across the keyboard. Fatal1ty and Zen barely speak during the intense 15-minute session. The only sounds are the roar of guns and the grunts of monsters. Final score: 51-8. Just then, Reisin sidles down the stairs. "Who's winning?" he asks. Everybody laughs.

THE CHALLENGERS

SANDER "VoO" KAASJAGER
Wendel's top rival. VoO has won four of six major CPL tournaments this year—bagging more than $89,000 in prizes.

ALESSANDRO "STERMY" AVALLONE
He idolizes Wendel and has used him as a role model since he first started pro gaming three years ago.

LAURENS "LAUKE" PLUIJMAEKER
Lauke beat Wendel at his own Fatal1ty Shootout last spring, winning an *Unreal Tournament* match.

A Taste of **Success**

WHAT MAKES FATAL1TY stand out from other top gamers? In addition to natural athletic ability and clever strategies, he works harder than many others. While they think of gaming as play, he considers it a full-time job—and puts in the commensurate hours. He also has some qualities that are hard to describe. After playing all of those hours and memorizing the look and feel of imaginary worlds, he gets into a zone, Zenlike, where much of what he does is instinctual. Then there's the X-factor: an unquenchable thirst for winning.

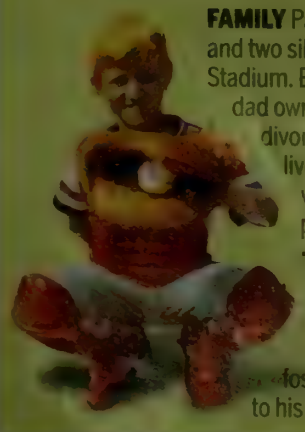
None of this is accidental. Wendel grew up in a striving blue-collar household in the shadow of Kansas City's Royals' Stadium. His parents worked in auto factories, and his father ran a pool hall on the side. A formative experience came when, at about age 7, young Johnathan fell while playing in a stream behind the pool hall and cut his wrist badly on some broken glass. A doctor recommended that he play sports to help complete his recovery. The kid obliged by mastering baseball, football, tennis, hockey, ping-pong, bowling, golf, and billiards. He takes play to an extreme. "Johnathan doesn't like to lose. He thinks he should win all the time," says his father, James. Wendel appreciates his dad: After he won $40,000 in a tournament in 2000, he plunked down $29,000 in cash and bought James a Cadillac.

With Mom, it was different. The parents broke up as Wendel was entering adolescence. His father had bought Wendel and his younger sister and brother a Nintendo console and let them play games on his PC, but Judy Wendel thought electronic games were a waste of time. She and her new husband were disc narians, and according to Wendel and his sister, Jenny, they ished the kids frequently for breaking rules. "Over and ove was grounded from playing on the computer—what he love do," says Jenny, 23, a college student. Wendel's mother woul comment on past conflicts. "I love my son. Gaming is his li don't interfere," she says.

After graduating from high school, Wendel dreamed of g pro. He was living with his dad, taking computer classes working part-time. The night before his first big tournamen Dallas in late '99, his father came into his bedroom to talk to about his future. "I told him I needed to go. I wanted chance," recalls Wendel. "I told him if I didn't win money, I' to school full-time."

He never got back to the books. Wendel won a $550 p and a week later, he won again—this time $4,000. In no ti

JOHNATHAN "FATAL1TY" WENDEL



BORN Feb. 26, 1981, in Independence, Mo.

EDUCATION Blue Springs South High School, 1999; attended computer classes at DeVry University.

FAMILY Parents James and Judy raised him and two siblings in the shadow of Royals' Stadium. Both were auto workers, though his dad owned a pool hall, too. His parents divorced when Johnathan was 13. He lived with his mother and stepfather, who often discouraged his game playing by taking away his computer privileges.

THE ATHLETE At 7, Johnathan fell and cut his wrist badly while playing in a creek behind his father's pool hall. A doctor advised that he play sports to strengthen his tendons. The exposure to sports fostered his passion for honing physical skills, and led to his playing football, baseball, hockey, and tennis.

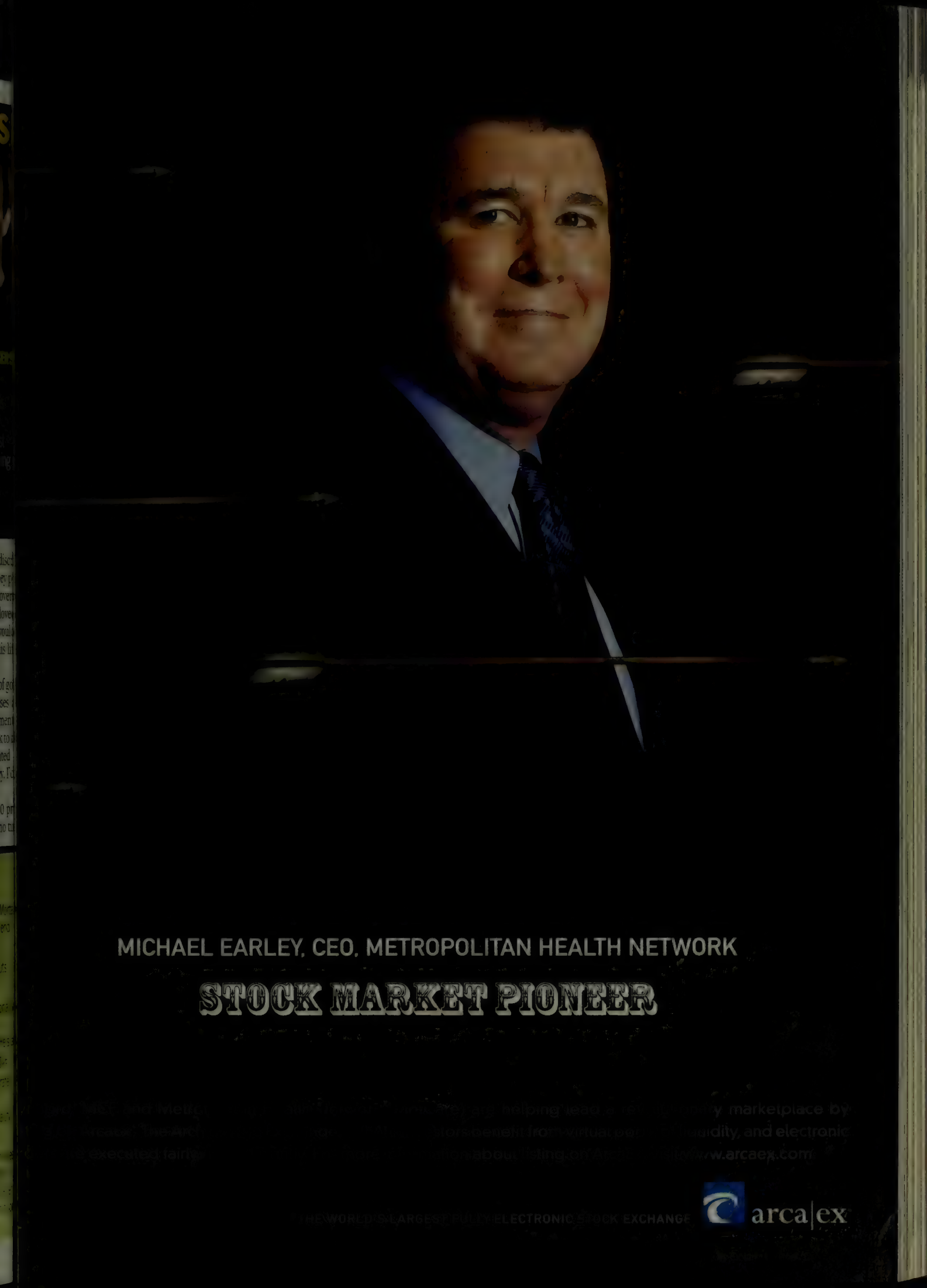
WHY FATAL1TY Wendel plucked the name from *Morta Kombat*, a favorite arcade game, in which matches end with the word "fatality" flashing on the screen.

GOOD LUCK CHARM When he competes he puts smU, a stuffed tiger, on top of his PC monitor.

TOP GUN Since he started competing professionally in 1999, Wendel has won 38 tournaments and collected more than $350,000 in prize money. He's a top player in the Cyberathlete Professional League.

THE ENTREPRENEUR Wendel is building a separate business around his own brand. He's working with technology companies such as Creative Labs to produce Fatal1ty gamer gear, from mice to cooling systems.

WHAT DRIVES HIM Wendel is a natural competitor who loves winning and detests losing. What gives him extra motivation, though, is a desire to prove his worth to his mother. "She never believed in me," he says. "The day I drive up in front of her door in a Ferrari is the day I close the door on that subject."


MICHAEL EARLEY, CEO, METROPOLITAN HEALTH NETWORK
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arca|ex

he was on the just-jelling pro circuit playing tournaments in far-flung locales from Seoul and Melbourne to Cologne and Rio de Janeiro. "Right then, I set my goal. I wanted to be the No. 1 player in the world," says Wendel. "I wanted to show my dominance, my skill. Being No. 1 shows your character and your will. You get so much respect."

Making his **Marque**

ALL THE TRAVEL IS A BLAST for Wendel and his pals. They often jet around together, and they make videos of their exploits. Once they flew into Turkey in shorts and T-shirts only to find a blizzard raging at the airport. At a Korean hotel, 30 people got into a cake fight in a hallway. They're supposed to go on a safari next week in South Africa. "We're walking around some weird country doing whatever we want," says Grapatin. "It's starting to get normal—which is weird in itself."

Over time, Fatal1ty, the ace gamer and good-timer, morphed into Fatal1ty the businessman. At first it was simple stuff. He designed a bigger-than-usual mouse pad featuring the Fatal1ty logo and started selling the pads online. But last year things got a lot more serious. He knew he could remain a top player only for so long, so he needed to build something more enduring than a win streak. He became the first—and so far, the only—gamer to get hardware makers to design products with his logo on them. His first partner was ABIT Computer Corp., a Taiwanese maker of PC motherboards and graphics cards. Next came Zalman, a maker of PC cooling fans—a must for gamers who tweak their processors to run fast and hot—and Creative Labs, a leading maker of PC sound cards and MP3 players.

Balancing business with gaming has proven tricky, however. It's VoO, not Fatal1ty, who's tearing up the pro circuit this year. There's no love lost between these two. Kaasjager admits he doesn't have much use for Wendel. "What can be quite annoying is he gets all the attention—much more than me," he says.

Over the summer, Wendel put more time into practice, and, by the time of the Dallas tilt in July, he was in top form. And the rivalry was fiercer than ever. Just before the finals, he returned to his computer to find Kaasjager sitting at his keyboard, fondling his lucky stuffed tiger, smU. Wendel shouted for Kaasjager to keep his hands off his stuff. "It was like somebody playing with Tiger Woods' putter. I went ballistic," Wendel recalls. He calmed down, though, and beat VoO resoundingly.

In Sheffield, after his defeat to Fatal1ty, VoO wins match after match. Ultimately, he fights his way into the finals, and the two arch-rivals face off on a brightly lit stage. The action is projected on giant screens above their heads. A crowd of about 70 gathers around the stage and cheers them on, while thousands more tune in via a live Webcast from Team Sportscast Network LLC. TSN "shoutcasters" call the play-by-play. Fatal1ty has an edge; he won their previous match. Now, he only has to win one best-of-three match, while VoO needs two matches in a row.

Yet Fatal1ty falters. The first game is close, but VoO triumphs, 22 to 20. In the second game, VoO wins 29 to 16. Fatal1ty is visibly frustrated, shaking his head as he plays. The first match is VoO's. After losing a third game, 33 to 16, he asks to have his PC changed, and officials spend 20 minutes replacing it, which doesn't help. VoO wins the final game in a rout, 17 to 9. When time runs out, VoO yells "Yes!" and Fatal1ty stands up, takes a deep breath, and shakes his head. "I played bad," he says. He thinks he may have overpracticed during long delays before the finals and tired himself out: "I'll be better prepared next time."

He'd better. The next big tournament comes at the championship in New York City. His backers make light o situation. "Even Michael Jordan misses a shot sometim says Lester Lau, gamer branding manager at ABIT. But, t is, the pressure is on. "The young guys are coming up, they're going to be challenging some of these old dinos like Johnathan," says Sheryl Huang, a marketing manage NVIDIA Corp., a maker of chips for gaming peripherals.

Could Wendel be over the hill at 24? In this game possible. He's keenly aware of the risks. "I'll have to p again for this event," he says. Later, in an e-mail, he a "Now my goal is to move onto the next big game (next y and become world champion at another game. But, befo give *Painkiller* a rest, I would definitely like to go out on to November."

Going out on top has a nice ring to it. And, for Wende would be especially gratifying. He has worked hard for years to build his skills, his brand, and his sport. Now comes big chance to show the world—and his mom—that he and game deserve their respect. ■

–With Beth Carney in Sheffield, Engl

YOUNG GUN Magistro, 16, one of the gamers at the Yonkers shootout

FOR OUR WRITER, IT'S FRAG OR BE FRAGGED

BY STEVE HAMM

There I was, a middle-aged reporter who had never played a shoot-'em-up PC game before, sitting in a darkened conference room at a Ramada Inn in blue-collar Yonkers, N.Y., and preparing to square off against a group of hotshot teenagers and twenty-somethings. My fingers sat paralyzed on a PC keyboard as I squinted through my glasses, trying to focus on the action on the monitor in front of me. We were going to be playing a team-warfare game called *Counter-Strike*. I hoped to avoid embarrassing myself.

BusinessWeek online For the full story on the Yonkers competition, go to www.businessweek.com/extras

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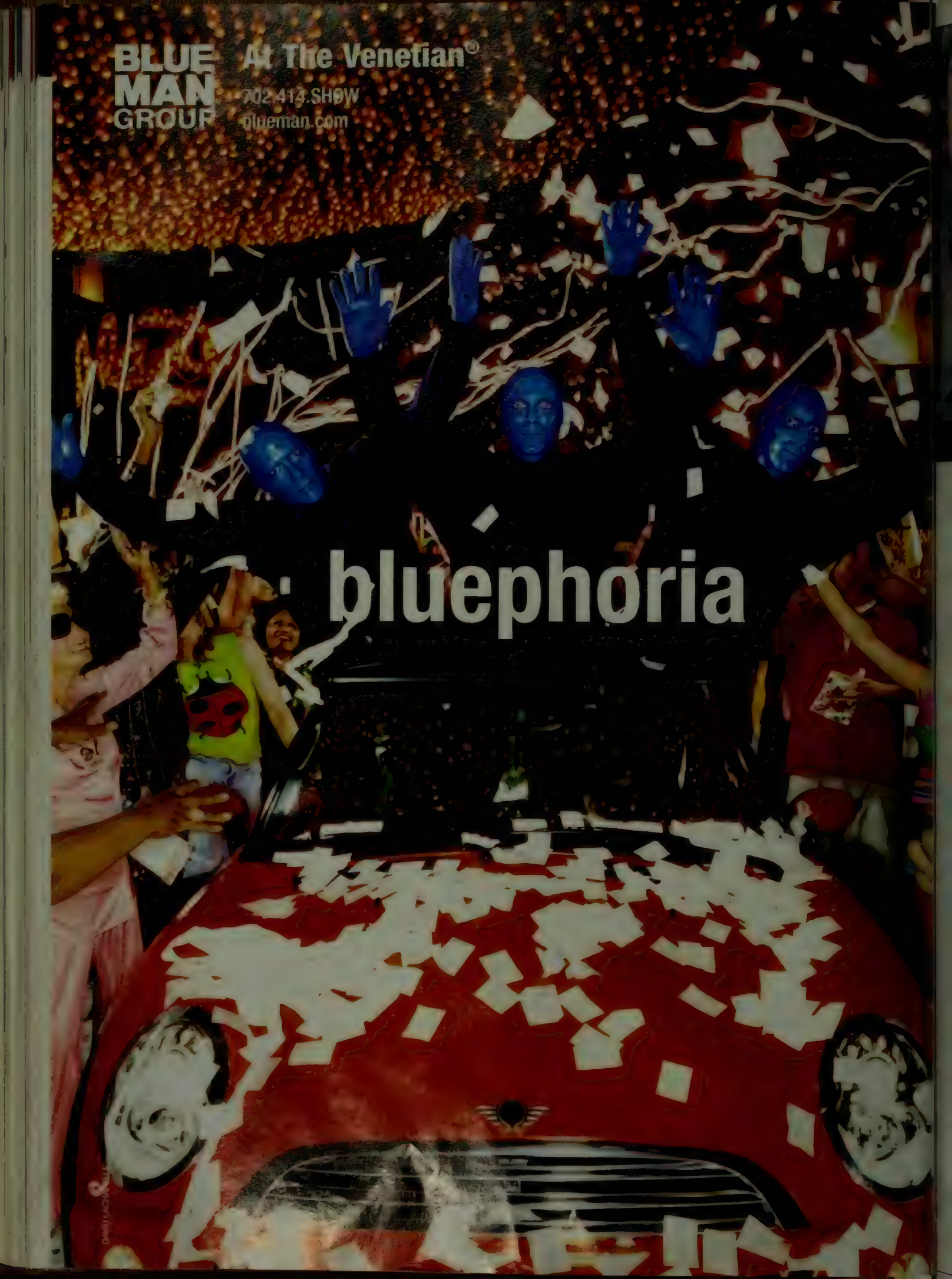
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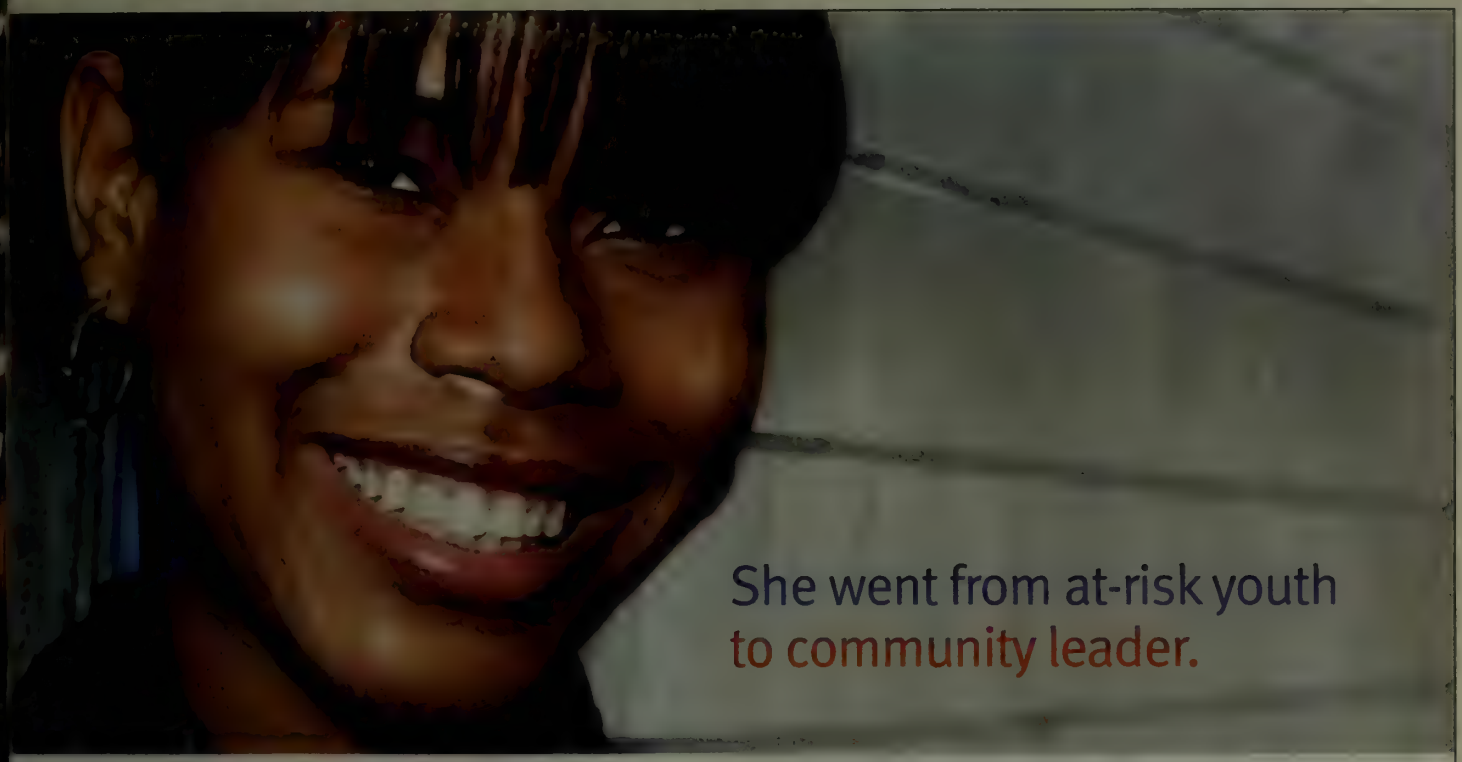

Ashley Bibbs

She woke to the sound of gunfire and watched helplessly as her father died in front of their house. Instead of staying angry, Ashley searched for ways to keep the same thing from happening to other kids.

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Amsterdam	01-12-2005	Madrid	26-11-2005	Barcelona	06-02-2006
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New York	03-12-2005			Monterrey	10-03-2006
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PRIME TIME As CEO, Thomas-Graham saw ratings slip at CNBC

A Better Fit at Liz Claiborne?

mela Thomas-Graham brings plenty of zz—and a spotty record at CNBC

PAMELA THOMAS-GRAham has always been a woman of bold ambition. After collecting multiple degrees from Harvard University and becoming the first black woman to e partner at McKinsey & Co., nas-Graham tapped a connection on General Electric Co. board to meet Chairman Jack Welch in 1999. ed by the articulate young consult- who wrote mystery novels on the side, h called NBC chief Bob Wright, who ed Thomas-Graham a shot to head edgling Web site for CNBC.

Thus began a tumultuous stint that saw Thomas-Graham rise in 2001 to become chief executive of CNBC—as well as a media star who graced magazine covers and won awards—during a period when ratings plunged more than 60%. While the business news network stayed profitable, insiders say that was largely due to locked-in cable fees and an elite if shrinking audience that kept ad dollars flowing. Thomas-Graham's main task was to invigorate the lineup, especially in prime time. Her offerings—starring such celebrities as John McEnroe, Tina Brown, and Dennis Miller—ultimately failed. Several highly placed insiders contacted by *BusinessWeek* felt that she didn't spend enough time at headquarters and seemed more focused on her image than on the health of the network at a time when it desperately needed more strategic vision from the top. Others, including Thomas-Graham herself, argue that she managed to make money and increase profit margins amid the dot-com bust and an atmosphere of corporate scandal that soured the taste for business news. Still, when she stopped handling daily operations to become the network's chairman in February, insiders assumed she would soon move on.

But few would have predicted her landing as a group president at Liz Claiborne Inc. Thomas-Graham, 42, welcomes the challenge. "This business is twice the size of CNBC and lets me work with a portfolio of brands rather than a single brand," she says. "I'm a Harvard MBA. Having a bigger P&L [profit and loss statement] and more complexity appeals to me." But the high-profile media executive is plunging into the world of everyday fashion at a time when the department store universe is shrinking and a basic boomer-oriented clothing line like Liz Claiborne must fight harder to stand out. Although it is profitable, veteran strategic consultant Harry Bernard argues that it is "not the fair-haired brand that it once was. I truly don't know who wears Liz Claiborne anymore." Bloomingdale's hasn't carried the line for years. One retailer as-

serts that "it's not worth a premium over [in-store] brands."

Certainly, hiring Thomas-Graham, who will step into her new role on Oct. 10, has already brought the brand some buzz. As a prominent woman in business, her career is closely tracked. She has been "woman of the year" in publications as diverse as *Ms. Magazine* and *Glamour*. She is married to Lawrence Otis Graham, a lawyer and controversial author who, among other things, documented his nose job in a book. In addition to nurturing a corporate career and three children, Thomas-Graham rises at 4 each morning at their estate in Chappaqua, N.Y., to work on the fourth novel in her critically acclaimed mystery series, which features a gutsy female African American Harvard economics professor named Nikki Chase.

PEER CRITIQUE

MANY PEOPLE who know her admit they feel uncomfortable saying anything negative about Thomas-Graham's record. She is an accomplished black woman working in a largely white, male, corporate world. She has impressive academic credentials and had what it took to make partner at McKinsey. Some former CNBC colleagues such as *Morning Call* co-host Ted David rave about her. Says David: "She is elegant, kind, generous, and fiercely bright."

Yet many peers fault her management skills, including her ability to build and lead teams—both at CNBC and previously at McKinsey. At CNBC, a number of executives contacted by *BusinessWeek* speak of a leader more interested in speaking appearances and networking than delving into the minutiae of operations. Thomas-Graham disagrees strongly. She [illegible] that, as a high-profile black busine[illegible] called on to speak [illegible] tant responsibility. Still, [illegible] client thought she wasn't [illegible] analysis. And some colleagu[illegible] wasn't a team player. "You want to see her succeed," says a female consultant, "but I would never want to work with her again."

Thomas-Graham argues that she was a "non-hierarchical manager" at CNBC who had an open-door policy with employees and who successfully created ways to keep a wealthy audience. She adds that she was passionately involved in operations. Moreover, she stresses that she made money and streamlined the business. Says Wright: "She was CEO during a rough patch."

While CNBC's wealthy demographics and cable subscription fees help keep profits in excess of $250 million a year, there is little to boast about in the way of ratings, which are another crucial measure of success. Nielsen Media Research reports that the network has lost about 60% of its daytime audience since 2001—and roughly 70% in prime time. That's during a period when CNN's financial network folded and News Corp.'s Fox has emerged to have the top five business shows on cable TV. "It's a network that hasn't found itself," says industry consultant and CNN co-founder Reese Schonfeld. For her part, Thomas-Graham points to several accomplishments: creat[illegible] reporter beats, focusing on investiga[illegible] journalism, launching documen[illegible] and pushing diversity—not to [illegible] the popular, hyperactive investment maven Jim Cramer on air.

Even fans, though, are hard-pressed to applaud such program choices as tennis star John McEnroe's short-lived [illegible] time talk show, which had the burd[illegible] having to woo guests to CNBC's [illegible] quarters in Englewood Cliffs, Thomas-Graham championed *Top[illegible] with Tina Brown*, only to see it als[illegible] flat in prime time. Brown says Thomas-Graham "had very little su[illegible] from above and was kind of hamst[illegible] by that." Neverth[illegible] Thomas-Graham sun[illegible] her time at CNBC as [illegible]rific experience. She [illegible] becoming chairman [illegible]er this year let her pl[illegible] strategic strengths [illegible] she helped the net[illegible] buy out Dow Jones & [illegible] stake in its internat[illegible] TV partnership.

Those strengths w[illegible] much needed in her [illegible] job of handling Liz [illegible]borne's $1.3 billion [illegible]ship brand, along [illegible] such women's clot[illegible] names as Sigrid Olsen [illegible] Collectibles, and E[illegible] James. Having a feel fo[illegible] products and the ability to forge stron[illegible]lationships with retailers also will be [illegible] Thomas-Graham isn't worried, saying [illegible] worked with at least six apparel bran[illegible] McKinsey and that "one of the things [illegible]sultants learn is how to get up to spe[illegible] a new company."

Thomas-Graham's new boss, Ex[illegible]tive Vice-President Trudy Sullivan, se[illegible] surprised by the media attention [illegible]rounding her new hire, noting tha[illegible] $4.6 billion company has four c[illegible] group presidents. In her view, Tho[illegible] Graham brings fresh eyes to the busi[illegible] She's "thoughtful, strategic, and a g[illegible] person to dialogue with," says Sulliv[illegible]

Thomas-Graham's fans expect h[illegible] prove her naysayers wrong. Says fo[illegible] *New Yorker* editor Brown: "Pam is a [illegible] civilizing force in a company, and i[illegible] right structure, her management s[illegible] will come to the fore." ■

–By Diane Brady in New

THE PRODIGY

Pamela Thomas-Graham

Group President, Liz Claiborne Inc.

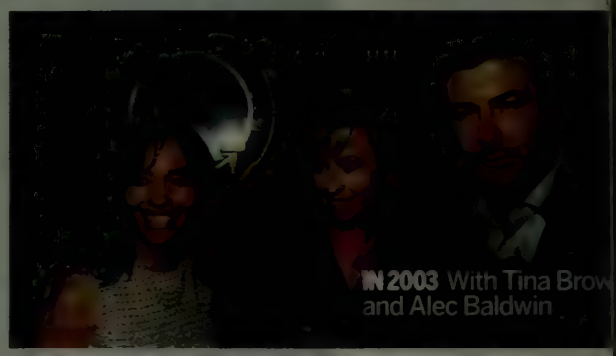
With a *Glamour* magazine award in 2001

STARTING POINT Born in 1963 in Detroit to politically active parents.

CHILDHOOD HEROES The lawyers of the NAACP Legal Defense Fund.

IVY LEAGUE PEDIGREE Pulled off a Harvard hat trick, earning a BA (Phi Beta Kappa) and a joint MBA and JD in its hallowed halls.

MAJOR MOVES Became chairman of CNBC after leaving the president and CEO role in February; first black woman to make partner at McKinsey.



IN 2003 With Tina Brow[illegible] and Alec Baldwin

DYNAMIC DUO Married to Lawrence Otis Graham, a lawyer, author, and one-time congressional candidate. The couple has three children.

SUPERMOM Rises at 4 a.m. to write murder mysteries (three so far) featuring a gutsy black female professor from Harvard as the protagonist.

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Social Issues Medicare

Medicare's Big Experiment

he coming changes aim to cut costs hile improving care. Sound familiar?

N 16 YEARS OF PRACTICING internal medicine, Yul D. Ejnes has learned to cope with the fast-changing world of medical economics. A decade ago, under tremendous cost pressures from big insurance companies, Ejnes ged his tiny practice in Cranston, R.I., what has since evolved into a 16-ce, 50-physician operation. Since lab s and X-rays can be more profitable n office visits, he and his partners set an in-house lab and are planning to elop their own medical-imaging busi-s. His practice, Coastal Medical Inc., n leverages its in-house computer em into a lucrative sideline: billing in-rs and patients for other docs.

Now, Ejnes is about to get the biggest e of change yet. Medicare, the giant ral health program that covers the ntry's 42 million seniors—and about -third of Ejnes' patients—is set to rad-ly overhaul the way seniors get their lth care. Washington has already ted giving insurance companies bil-s of dollars in subsidies to encourage iors to join managed-care plans—the vorks of doctors and hospitals that are the near-universal model for em-er-provided health care.

Vashington will also aggressively pro-e disease management in Medicare, re chronic illnesses are identified and ted early. It will urge doctors to adopt ly new information technology. And it soon take steps to tie physicians' pensation to the quality of care they vide. Taken together, "this is really ut shifting the focus to helping people well in the first place," says Mark Mc-len, administrator of the federal Cen-for Medicare & Medicaid Services, ch oversees both programs.

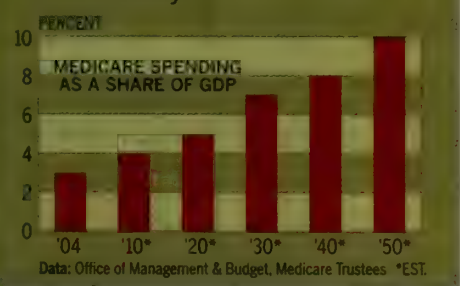
Perhaps. But these changes are also about saving money. Over the next few years they'll not only remake the way medicine is practiced on seniors but also shake up the world for physicians and hospitals and change the way taxpayers pay Medicare's unimaginably huge bill.

In the new world of Medicare, seniors will face the same option workers have confronted for years: Accept limited choices of doctors and hospitals or pay more. Like their younger counterparts, seniors may be getting streamlined care—more of their surgery will be done in walk-in clinics, for example, rather than in hospitals. And they'll have to become more aggressive consumers of health care. Take Medicare's new drug benefit: With help paying for their prescriptions, seniors should be able to better integrate their medication with other care—but only if they make sure their drug plan covers the specific pills they take. Says Patricia Neuman, a health economist at Henry J. Kaiser Family Foundation: "This could fundamentally change patient care."

Doctors, meanwhile, may be pushed to provide more preventative care rather than costly treatments for the very ill. And the small medical practice may go the way of the neighborhood pharmacy.

UNSUSTAINABLE

If Medicare continues on its current path, it will absorb a huge chunk of the economy



Data: Office of Management & Budget, Medicare Trustees *EST.

After years of battling reform, Ejnes and many of his colleagues are open to change. Medicare's old fee-for-service system, where doctors are paid a piece rate for each procedure or test they perform, is like "a dog doing a trick and getting a biscuit afterward," Ejnes says. Trouble is, for years doctors have heard that Medicare would pay more for better care, only to see payments slashed. Patients, too, have heard unfulfilled promises of better care for less cost.

Indeed, Medicare has experimented with managed care twice before, but the system imploded when budget pressures forced Washington to cut subsidies to insurers. Without the extra cash, insurers raised premiums, cut benefits, and eventually dumped the no-longer-profitable plans. Doctors and senior advocates wonder if the result this time will be the same: a system that merely pays less.

BOOMERS LOOM

BUDGET PRESSURES are only getting worse. The government spends 2.7% of the nation's total economic output on Medicare. In the coming four decades, as baby boomers retire and demand costly new technologies to keep them healthy, Medicare threatens to break the federal bank. Spending for the program will nearly quadruple—to almost 10% of gross domestic product.

The drive to managed care is nothing new for people who get their health insurance from their employer. Just 3% of working people today are in old-style plans that give them an unlimited choice of doctors and hospitals and do little to restrict their access to costly medicines or procedures. By contrast, nearly 90% of Medicare recipients are treated under that old fee-for-service model.

The new system, established by the same 2003 law that created the Medicare prescription-drug benefit, aims to make managed care—known as Medicare Advantage—nearly universal among the elderly. Insurance companies are expected to use Washington's subsidies to provide extra benefits, such as vision or dental care, and lower premiums. Emory University health economist Kenneth E. Thorpe figures those added benefits will

be worth an extra $615 a year. In return, however, members will face more limits on their choice of doctors and hospitals.

The carrot of subsidies is accompanied by a stick: sharply rising premiums for traditional Medicare. In 2006 seniors are likely to pay $120 or more a month for basic Medicare plus the new drug insurance. Many can expect to spend $100 to $200 more for a supplemental Medigap plan, which pays deductibles and other fees left over by basic Medicare. That's a lot, especially for a senior living on a small pension and Social Security, which pays an average of roughly $1,200 a month. And with health costs skyrocketing, those premiums will explode in coming years. A 2004 Urban Institute study estimates that Medicare premiums alone will rise to nearly a quarter of total Social Security benefits by 2040. Add Medigap premiums, and many retired baby boomers could be spending 40% of their Social Security on health care.

That will drive a steady shift to the new Medicare managed-care plans offered by insurers and HMOs. Even so, it's likely to be a gradual process because many seniors will hang on to traditional Medicare as long as they can. "The potential for managed care to become dominant is many years off," predicts Paul B. Ginsburg, president of the Center for Studying Health System Change, a Washington research organization.

Backers of managed care hope the real benefit will come in Medicare's ability to coordinate care for the chronically ill. Seniors typically suffer from multiple chronic illnesses, such as arthritis, congestive heart failure, and high blood pressure. If managed-care plans can coordinate all that treatment, there's at least a chance that care can improve at less cost.

INFO-TECH UPGRADES

ACHIEVING THAT GOAL will require a major retooling of physicians' practices. To start the transition, Medicare will demand more information on how doctors care for their patients. It's establishing a series of specific quality measures aimed at encouraging docs to use "best practices" in treating patients. For example, physicians will have to show whether they have performed specific blood tests and foot exams on diabetics to prevent complications that lead to amputations and kidney disease.

Gathering that data, in turn, will require new computer systems that are in use at only a handful of medical practices today. Doctors recognize the need for the technology upgrade but wonder how they'll pay for it. One study suggests that installing the PCs and highly specialized software needed to manage tasks such as writing prescriptions and tracking patient care costs a small practice as much as $44,000 per doctor.

Together, all these changes may mean the demise of the solo practitioner, who probably won't be able to shoulder the new burdens alone. "One-, two-, and three-physician practices are, by definition, undercapitalized and inefficient," says Scott Latimer, regional vice-president for senior products at Humana Inc., a Louisville-based health insurer.

Just as small physician practices will fundamentally change, so will big hospitals. They'll still do intensive, high-tech, high-profit procedures such as heart bypasses. But less complex surgeries and nearly all testing will be done at smaller walk-in centers. That should save money. But will it improve care?

It's where the next step will come in—and it's a big one. Medicare wants to start tying doctors' payments to results. Backers hope such financial incentives will encourage doctors and hospitals to keep patients healthy. Managed care has made the same promise for 20-plus years—but has rarely delivered. Instead, the system has tried to slow spending growth by limiting care. Insurance execs say it will be different this time. But the key to managed care's future may depend on how long those big government subsidies continue. And in an era of huge deficits, it is a good bet they'll dry up. If it does, the move to managed care may blow away as well.

In that environment, both traditional Medicare and the new managed-care plans will be under tremendous pressure to control costs. Inevitably, they'll be tightening the screws on doctors and hospitals. Just as Wal-Mart demands the best quality at the lowest price from its vendors, those that pay the health care bills will demand that physicians and hospitals do the same.

But health care is not home electronics. Often, attempts to save money end up costing more—at least in the short run. For instance, big subsidies to Medicare HMOs will raise the government's costs at first. Similarly, disease management may result in more intensive treatment for the chronically ill. That could improve their health, but at a higher cost.

Experts have never had much luck guessing what the medical system will look like 5 or 10 years down the road. And the results of changes as big as these are even tougher to predict. Says former Congressional Budget Office Director Robert Reischauer: "These are the first steps down very long roads, filled with lots of potholes and overhanging branches."

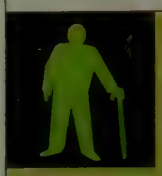
But with many seniors, doctors, and taxpayers all convinced they were getting a raw deal from the existing system, it's little wonder Congress was willing to roll the dice in a major way. The pols have assured the public that a decade from now health care for seniors will be much different than it is today. The question remains: Will it be better? ■

–By Howard Gleckman in Washington

> A key goal is shifting focus from treating to preventing illness

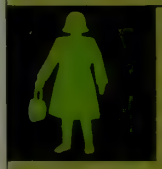
The New World of Medicare

The federal health program for 42 million seniors will get a radical overhaul as the 2003 Medicare modernization act kicks in. Here's what to expect as it steers more recipients into managed care and disease-management programs and sharply expands the use of info tech in hospitals and doctors' offices:



SENIORS They will need to make far more choices about their health care and learn to treat it more like any other consumer purchase. They can also expect higher premiums and out-of-pocket expenses. The good news: a new focus on preventative care.

DOCTORS AND HOSPITALS Cost pressures will grow as Uncle Sam and insurers demand better outcomes. Solo practitioners will find it increasingly tough to survive in the costly new productivity-driven environment.



TAXPAYERS Although aging baby boomers and costly new technologies will continue to drive up the Medicare tab, new rules will begin to shift more of the pain to patients and health-care providers.

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IP Telephony

The vision of a truly mobile workforce comes to life

It's 9 a.m., Monday: Do you know where your employees are?

Chances are they're anywhere but at their desks. They could be working from a hotel room, at home, or from a branch office, in their cars or on planes en route to a meeting, roaming the corporate corridors on their way to a conference room, or off-site at a sales call or training seminar. Indeed, the very nature of work today has become highly mobile, and enterprises are no longer constrained by the four walls that make up the corporate headquarters.

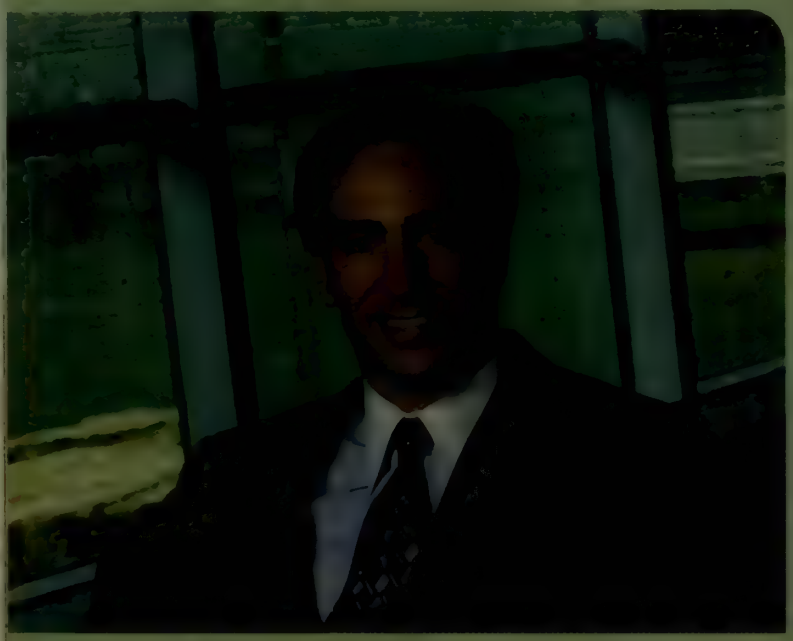
When it comes to the U.S. workforce, it seems that hardly anybody's staying put these days. Market researcher IDC estimates that two thirds of the workforce will be considered mobile by next year, while In-Stat MDR forecasts that by 2008, the population of remote and or mobile employees will increase to 105 million, or more than 72% of the worker population.

With this dramatic rise in mobility, new challenges have been created to ensure that peripatetic professionals stay connected to each other and to essential, mission-critical corporate applications and information resources. Coming to the rescue are a host of new IP, or Internet Protocol-based, communications products and services that provide powerful solutions for this growing on-the-move workforce. Says communications guru Jeff Pulver, chairman and founder of pulvermedia, based in Melville, N.Y.: "IP telephony technology provides the means to extend the enterprise beyond its physical boundaries, giving mobile workers a new competitive edge."

According to Michael Antieri, group executive, product management, at AT&T Corp., in Bedminster, N.J.: "VoIP is adding a whole new level of productivity to the workforce. Because of the flexibiljty of VoIP, more calls are being answered. More work is getting done.

IP Telephony

It goes without saying, too, that enterprises become more agile when their employees are able to stay connected more effectively." Remote employees can leverage elements of their corporate communications



"VoIP is adding a whole new level of productivity to the workforce," says AT&T's Michael Antieri.

environment more effectively and utilize many of the features found in the office such as corporate directory listings, voice-mail applications, and call forwarding, though 911 capabilities may be limited for certain nomadic users.

The Phone System is the Network

VoIP services can be provided using a dedicated on-site IP PBX phone system, or by new network-based services, sometimes referred to as hosted communications. One such service, AT&T's Voice DNA, is the first service to be launched within the company's new Dynamic Network Applications (DNA) portfolio, providing enhanced features such as switch phones (mid-call move), personalized call handling, on-demand audio conferencing, and integration with Microsoft Office Outlook. The service comes with a choice of calling plans (any distance and local), a full suite of comprehensive online management tools, personal portals for end users, and support for softphones as well as a number of IP phones.

AT&T's DNA is an integrated portfolio of network-based IP communications services designed to increase the productivity of business users while reducing the complexity of managing enterprise communications solutions. On a march to deliver integrated voice, video, conferencing, and messaging capabilities, this system is a harbinger of the next generation of converged business communications.

With AT&T DNA, enterprises should experience improved control and stronger cost management along with many new capabilities. Services within the DNA portfolio are unique in the personalized control they provide both to users and network administrators. Delivered through a unified online Web portal—AT&T BusinessDirect—the online tools are designed to be intuitive and thus easy to use. In addition, DNA services leverage AT&T's world-class IP-MPLS backbone, its application-aware networking environment, and its industry-leading VPN portfolio.

We can see you

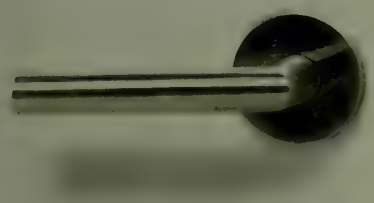
One of the greatest enemies of productivity is wasted time. So by association, any business solution that more easily and quickly puts workers—especially mobile workers—in communication with one another and with the vital corporate information they need is an ally of productivity. HiPath OpenScape middleware from Siemens Communications Inc., in Boca Raton, Fla., aims at speedily synchronizing people and information and thereby expediting decision making. Cutting to the chase like this drives down the total cost of ownership of communications resources and drives up productivity.

Capable of working in any IP infrastructure environment, HiPath OpenScape knits together phones, video, voice mail, e-mail, text messaging, instant messaging, calendaring, and conferencing services. Moreover, HiPath OpenScape integrates these fast-

AT&T and VOIP

Can your network say it's taken the plunge?

NAVIGATE THE FUTURE. When we wanted a deeper understanding of how VoIP could help transform businesses, we volunteered ourselves. Our implementation of VoIP allowed us to save $500 per employee annually. Not only that, VoIP also enhanced our remote working initiative that resulted in a 12.5% increase in productivity and savings of $180 million annually. Soon, up to 20,000 AT&T employees will be using VoIP. When it comes to VoIP, we at AT&T didn't just get our feet wet, we dove in. We can help you do the same. **CAN YOUR NETWORK DO THIS?**



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IP Telephony

growing communications services into existing business processes and applications, achieving even greater productivity gains.

Working within the HiPath OpenScape environment, an employee can glance quickly at her contact list and see in real time the availability information of a particular contact—in his office, for instance, or at a meeting or lunch. Reaching that contact then becomes a one-step process, whether via phone, instant message, or e-mail. Need to caucus? With a

"IP telephony technology provides the means to extend the enterprise beyond its physical boundaries, giving mobile workers a new competitive edge."

—Jeff Pulver, pulvermedia

single click, a HiPath OpenScape user can initiate a conference with team members and easily share documents. How about charts? A manager can launch a multi-media session by starting a Web conference with popular tools such as Microsoft's Live Meeting. Ample security has been integrated into HiPath OpenScape, including Microsoft.NET security features and support for standard security protocols such as Kerberos, TLS, and IPSec.

Out of Sight, Not Out of Touch

Through the power of IP-based communications solutions, today's mobile workers are empowered to go wherever their work takes them, while staying productive, in contact, and fully responsive to the needs of their company. From virtually anywhere in the world, workers can maintain seamless connectivity to corporate telephony and information resources. The concept of a fully distributed yet completely efficient enterprise has become a reality.

About the Author

Marc Robins is an internationally known expert in the field of IP telephony and emerging new IP communications technologies, with more than 24 years experience in the communications industry as a reporter and analyst, conference producer and publisher, and marketing executive and consultant. From 1998 to 2003, Marc served as vice president of publications and trade shows and group editorial director at TMC, publisher of the trade magazine *Internet Telephony*, and producer of the *Internet Telephony Conference & EXPO* trade shows, for which he also served as chief architect and conference co-chairman. Today, Marc runs an IP communications industry marketing firm, and has recently launched a new publishing company focused on providing definitive sources of information for prospective buyers of IP communications technology. For more information about Robins Consulting Group services, contact Marc at 718-548-7245 or e-mail robinsconsult@optonline.net.

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Is This Disease For Real?

"Metabolic syndrome" may put you at higher risk for heart disease and diabetes, but many doctors question the diagnosis. **BY CATHERINE ARNST**

AS YOU READ THIS article, you may be feeling pretty good about your health. Sure, your blood pressure is a little high, and your HDL reading (otherwise known as the "good" cholesterol) is low. But you are far from obese, despite that spare tire around your waist, and none of these problems on their own seem serious. ¶ You'll be shocked, then, if during your next checkup, your doctor says you are at heightened risk of developing heart disease and diabetes. Suddenly, you don't just have high blood pressure or low HDL. You have metabolic syndrome, a disease that seems to be sweeping the nation—even though the diagnosis is controversial. ¶ Metabolic syndrome, sometimes called syndrome X, was first defined in 1988 as a collection of health risks may increase the chances of develop cardiovascular disease two-and-a-ha four times, and diabetes by four to times. Besides abdominal fat, high bl pressure, and low HDL levels, the ba of risk factors that can lead to a diagn includes insulin resistance and h triglyceride levels. To be tagged with diagnosis, all you need is three out of and plenty of people meet the stand Recent surveys estimate that as man 25% of all Americans, and 44% of th age 50 and older, have metabolic s drome. The number of prescripti written for metabolic syndrome jum 36% between 2002 and 2004, says c sulting firm Medco Health Solutions.

Those prescriptions, however, are for the e blood pressure and cholesterol man- ment pills that patients would be given ey weren't labeled with this particular gnosis. In fact, there's no proof that a bination of risk factors is any more dan- ous to your health than each factor con- red separately. That makes the notion etabolic syndrome as a distinct disease fusing to patients and doctors alike.

This lack of clarity has led to a face-off ween cardiologists and endocrinolo- s over the validity of metabolic syn- me as a diagnosis, with each group is- g diametrically opposed statements. American Diabetes Assn. (ADA) said August that metabolic syndrome is orly defined, inconsistently used, and in need of further research." Dr. Richard Kahn, chief medical officer of the ADA, insists that metabolic syndrome, "doesn't exist. There is no scientific evidence proving that this is a distinct disease."

ATTENTION GETTER

ON THE OTHER SIDE, the American Heart Assn. (AHA) issued a report in September stating that "metabolic syndrome is an important issue for physicians and the general public." The AHA strengthened its criteria for the disease, and for added heft it issued those criteria in partnership with a division of the National Institutes of Health.

What's a patient to make of all this? The answer, say many experts, is to worry about the risk factors, not the label. "From a practical point of view, this diagnosis tends to get people's attention," says Dr. Roger Blumenthal, director of Johns Hopkins Ciccarone Preventive Cardiology Center. "Most doctors think this is a good way to focus the patient on the overall problem."

That problem is a collection of seemingly unrelated health measurements. According to the AHA, metabolic syndrome exists if a patient meets any three of these criteria:

- A waist circumference of 40 inches or more in men and 35 inches or more in women, independent of overall weight
- A triglyceride level of 150 milligrams per deciliter (mg/dl) of blood
- HDL-cholesterol levels of 40 mg/dl or lower in men and 50 mg/dl or lower in women
- Blood pressure above 130/85
- Elevated glucose levels

None of these factors is considered more serious than the others. Nor do doctors know if any one could lead to another. But there is a growing sense that abdominal fat, the kind that globs up around the internal organs, is an obvious warning signal because it can release all kinds of chemicals that interfere with proper metabolism. One study even found that overweight women whose fat collected in the thighs and hips were healthier than women with lower body mass but large waists. Don't be fooled by a slender waist, however. You can still have metabolic syndrome if three of the other risk factors are present.

As for treatment, cardiologists, endocrinologists, and the American Association of Family Physicians all agree that lifestyle changes are the preferred method. "Dieting and moderate exercise are the best things you can do," says Dr. Rita Louard, director of the Clinical Diabetes Program at Montefiore Medical Center in New York. "And those are the hardest things we ask people to do."

The good news is you don't need to lose lots of weight to see an improvement. A diabetes prevention trial in Finland found that, in a group of middle-aged overweight men and women, losing 8 to 12 pounds over two years, reduced the risk of developing diabetes by 58%. Ideally patients diagnosed with metabolic syndrome should get within 20% of their ideal weight and aim for 15 to 30 minutes of brisk activity a day.

If such lifestyle changes are unlikely, a variety of drugs—with a slew of side effects—address each risk factor. The Mayo Clinic lists five categories for metabolic syndrome: weight-loss drugs, aspirin, insulin sensitizers such as Glucophage, blood pressure medicines such as ACE inhibitors and diuretics, and statins for regulating cholesterol.

There is a single drug on the horizon that some specialists say may be useful against the disease. Acomplia is awaiting Food & Drug Administration approval as a diet drug that blocks hunger cravings, but developer Sanofi-Aventis is also positioning it as a potential treatment for metabolic syndrome. That may be a long shot, Louard cautions: "I don't think one drug is going to do it. If I were going to have one message, it's that we as a society have to be aggressive on lifestyle modification." A hard message, but an increasingly necessary one. ■

More on Metabolic Syndrome

AMERICAN ACADEMY OF FAMILY PHYSICIANS
familydoctor.org/826.xml

AMERICAN DIABETES ASSN.
800 342-2383; diabetes.org

AMERICAN HEART ASSN.
800 242-8721; americanheart.org

THE CLEVELAND CLINIC HEALTH INFORMATION CENTER
800 223-2273, Ext. 43771; clevelandclinic.org

CRETE Fine whites come from southern Greece

Way Past Retsina

High-quality Greek wines are making a strong comeback in export markets. **BY DAVID KILEY**

FOR THOSE WHO EQUATE Greek wine with palate-chafing retsina, traditionally laced with pine resin, it's high time to go exploring. Greece, which began exporting its winemaking methods to France and Italy as far back as the eighth century B.C., is trying hard to make a comeback. Greek winemaking was interrupted by 400 years of rule—ending in 1821—by the Ottomans, whose taxes on wine suppressed grape cultivation, and later by diseases that wiped out vineyards. Later, two world wars took attention away from serious winemaking.

Wine exports from Greece to the U.S. have been slowly climbing as better wine has hit the market. Greek vintners have shipped more than 200,000 cases to the U.S. this year, up about 25% from 2000. In general, the better whites come from the southern regions—the Peloponnese, the Aegean islands, and Crete—where they complement the abundant seafood diet, while Macedonia, Thessaly, and Thrace in the North produce more reds. In all, Greece is home to some 300 native grape varieties.

EXOTIC Most Greek grape varieties are unfamiliar

Improvements in the wines go hand in hand with the increasing sophistication of Greek cuisine. At Onera, a restaurant on Manhattan's Upper West Side, executive chef Michael Psilakis carries some 200 Greek wines in his c lar. Psilakis pairs his "c constructed" moussak which is made w braised goat and tru oil—with a pinot noir-l xynomavro from Boutari winery. His sk jack tuna served alm raw with radish and bl olive salad, tomato oil, a goat milk yogurt goes s prisingly well with a r varietal wine, agiorgiti also known as St. Geor produced by the Kou winery. "There is a spiri al connection betwe pairing Greek variet with Greek dishes, l these wines are incre ingly able to stand up to non-Greek fo too," says Psilakis.

Because Greek vintners face a mark ing handicap—the varieties of grapes unfamiliar, and the labels often cont Greek characters—you can find many cellent values. A 2001 blend of kotsifali a mandalaria grapes from the Minos regi of Crete, aged in oak for 10 months, co just $13. The blend is reminiscent of pi noir and tastes good with lamb or a big- vored Greek cheese such as Ladotiri of M tilini, made from sheep's or goat's m and preserved in olive oil.

SWEET AS HONEY

RED AND WHITE TABLE wines fr Amethystos Wines, priced at $15 to $2 bottle, stand up well against comparab Italian wines. The $20 dry white is blend of sauvignon blanc with semill and assyrtiko grapes from Macedo and is a fine match with octopus. At abo $7 a bottle, a muscat from winemal Kourtakis on the Aegean island of Sam offers an extraordinary value. I liked unabashed honey taste compared wi some Italian and California muscats th try to restrain the sweetness.

Greece is also turning out cabern and merlots from French vines planted the past 20 years. These are less intere ing—compared with competitors fr France or even California. Then aga why turn to Greece for French and It ian-style wines when you can taste nati varieties of the type enjoyed by Hom and Plato? ■

BusinessWeek online Please go to businessweek.com/extras for tasting impressions of a dozen wines, and a podca on the latest in Greek wine and food

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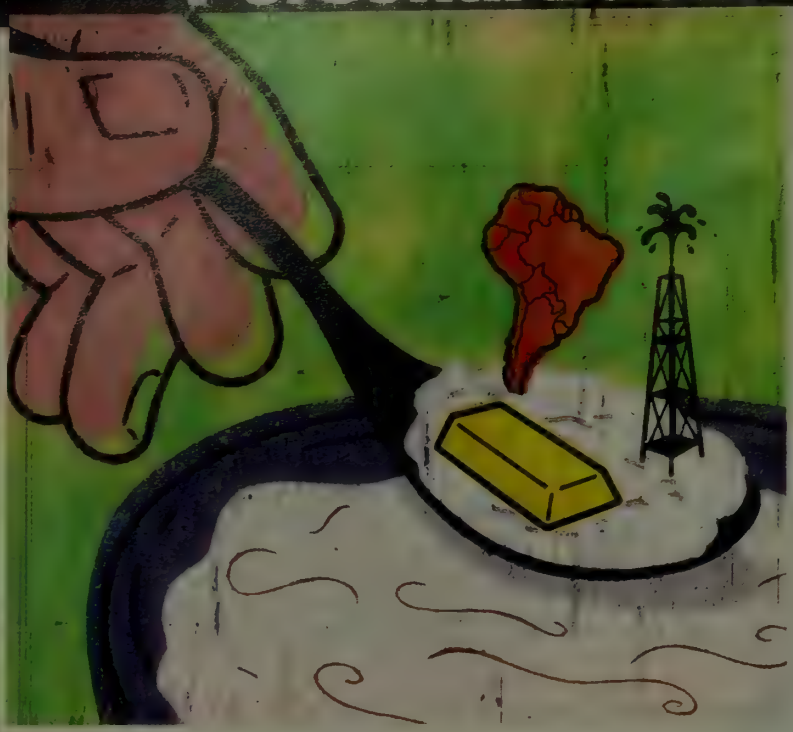

The Growing Interest in Growth Stocks

Lately this sector is outrunning value funds. **BY LEWIS BRAHAM**

IF YOU HAVE ANY DOUBTS THAT it's time to dump value stocks for growth issues, talk to Harry Lange. The manager of the $7 billion Fidelity Capital Appreciation Fund has the freedom to buy any kind of stock—small, large, U.S., foreign, growth, or value—and right now he is heavily into growth. "Growth stocks are as cheap as they've been relative to value in 30 years," he says. "Many stocks in the technology, medical devices, telecom, and biotech sectors have the same or lower price-earnings ratios as more defensive value stocks." About 38% of his portfolio is now in tech, up from 25% a year ago.

In recent years the market has often disappointed those who bet on growth stocks, but no more. In the third quarter, mutual funds investing in growth stocks—no matter whether small-, mid- or large-cap—trumped their value counterparts, with the average mid-cap growth fund delivering a 4.5% total return, the best of any diversified domestic equity fund category. That said, the perennially favorite small-cap value group nipped at its heels, with a 3.9% total return, while the Standard & Poor's 500-stock index delivered 2.4%. (Returns are through Sept. 27.)

GROWTH IS CHEAP

THE WINNING SORTS of funds for the past three months include precious metals, natural resources, and emerging markets—especially Latin America. These funds, all but ignored by investors for years, are gaining some traction, along with the Tokyo stock market. They're up 16.3%. The returns for bond funds look skimpy by comparison, no surprise given that the Federal Reserve continues to raise interest rates. All told, taxable funds eked out just a 0.2% return on average, and tax-free bond funds fell 0.2%. Long-term bond funds, which are the most sensitive to rate increases, suffered the most, falling 1.9% on average.

Value funds did manage to deliver decent performances, although after four years of strong returns, there's not a lot of opportunity in those stocks. Even Ben Inker, director of asset allocation at [illegible] $100 billion investment shop Grantham, Mayo, Van Otterloo, says high-qua[illegible] growth stocks are more attractive. "[illegible] years companies with low profit marg[illegible] and high debt loads have done well," s[illegible] Inker. That has led to a situation in wh[illegible] high-quality companies in the bevera[illegible] food, health-care, and technology sect[illegible] have become relatively cheap, trading [illegible] p-e ratios that are lower than that of [illegible] market as a whole. "Normally, such iss[illegible] trade at a premium," he says.

What concerns Inker is the moment[illegible]

Growth Funds Take the Lead

CATEGORY	TOTAL RETURN*	CATEGORY	TOTAL RETURN*
Latin America	26.29%	International Hybrid	4.17%
Natural Resources	20.59	All Cap	4.03
Precious Metals	17.96	Small-Cap Value	3.89
Japan	16.28	Large-Cap Growth	3.45
Diversified Emerging Markets	15.78	Small-Cap Blend	3.42
Diversified Pacific/Asia	12.67	Mid-Cap Value	3.13
Foreign	10.10	Mid-Cap Blend	3.06
Europe	9.34	Large-Cap Blend	2.78
Pacific/Asia ex-Japan	7.85	Large-Cap Value	2.55
World	6.67	Domestic Hybrid	2.04
Health	6.19	Real Estate	1.48
Utilities	6.10	Financial	0.53
Technology	5.74		
Communications	5.26	International Equity Funds	10.05
Mid-Cap Growth	4.47	All Equity Funds	4.59
Small-Cap Growth	4.35	U.S. Diversified Funds	3.41
Co[illegible]	4.31	S&P 500 w/Dividends Reinv.	2.38

*Appre[illegible]stment of dividends and capital gains before taxes. July 1-Sep. 27, 2005

Data: Standard & Poor[illegible]

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behind lower-quality companies. This is especially true of small-cap stocks, which look as if they're well on their way to a seventh straight year of beating large caps. "They're less profitable, more volatile, and have more debt on their balance sheets than large companies," says Inker. "They're also more expensive." Even veteran fund manager Charles Royce, who oversees $20 billion worth of small-cap funds at Royce & Associates, doubts that "we'll see any outperformance of small caps over the next five years."

DEEP VALUE

THERE ARE ALWAYS exceptions. Fidelity's Lange has found opportunities in smaller technology and medical-device stocks. Ajay Krishnan of the Wasatch Global Science & Technology Fund says many small chipmakers are attractive—mainly niche companies that manufacture chips for cell phones and flat-panel TVs. One of his favorites is Leadis Technology, which designs and manufactures display driver chips for cell-phone screens. It currently trades at $6.69, a little more than the cash per share on its balance sheet.

Some deep-value hounds have even begun buying tech companies, finding better deals there than in the industrial and financial stocks they usually favor. Manager Bill Nygren of the $7 billion Oakmark Fund recently scooped up shares of Sun Microsystems and Texas Instruments. Over the past quarter, manager James Barrow of the $30 billion Vanguard Windsor II Fund has amassed enough shares in Hewlett-Packard and Nokia that they now make up 5% of his holdings. "It has been seven or eight years since I owned tech stocks," Barrow says. He also likes blue-chip companies in the pharmaceutical sector. Such names as Pfizer, Bristol-Myers Squibb, and Wyeth account for 13% of his portfolio. "They're pretty cheap right now, but when we see some new drugs coming through the pipeline, they'll move up," he says.

Some value investors are hot on tech again—after a long cool spell

Co-manager Eric Bjorgen of the "go-anywhere" fund, Leuthold Core, which can buy stocks, bonds, or commodities, also favors health-care stocks, and they account for 28% of the equity side of his portfolio. A quant who uses computers to pick stocks, Bjorgen says that of the 150 industries he covers, a number in health-care fields are consistent leaders in his screens. "We've got a position in big pharmaceutical companies that's almost 10% and another 13% in a conceptual group we call health-care cost containment companies which offer products or services that help reduce costs," he says. "It's a play on or a hedge against health-care inflation and we think it's a group that will have a good fundamental story for the long term." One of his favorites is Cerner, a software maker that helps hospitals and clinics manage their inventories more efficiently.

The two sectors that continue to generate stellar returns—oil and gold—are also the most controversial. Some managers, such as Wasatch's Krishnan, who also heads up the $1.2 billion Wasatch Ultra Growth Fu think that energy stocks may be in a b ble similar to the dot-coms in 2000. the end of the day, oil is a commod subject to the whims of the economy," says. "It shouldn't be reclassified a high-powered growth s tor, the way some fund know have done." But m ager Dan Rice of BlackR Global Resources Fund. 29.7% this quarter, says t the market is valuing stocks as if their reser were worth $40 a barrel stead of today's $65. "Th is absolutely no evidence a lower demand or an creased supply of oil on horizon," he says. "How that a bubble?" Manager Frank Holn of U.S. Global Investors Gold Shares, 22%, sees similar supply constraints his sector, noting that because of str gent new environmental regulations now costs $1.4 billion on average to bu a new gold mine. He argues that inves demand for the yellow metal is picki up—because it's a hedge against inflat and a diversification tool.

Certainly, international markets general, and emerging markets in par ular, have benefited from the rise in co modity prices, as most production occ outside the U.S. Brazilian oil giant Pet brás is the largest holding in T. Ro Price Latin America Fund, up 27.8% t quarter, and with a forward p-e of 5, i the cheapest oil company in the wor says manager Gonzalo Pangaro. Yet P garo says Latin America offers more th just commodities to investors. He h been buying into initial public offerings Brazilian cosmetics company Natura a Mexican homebuilder Urbi. The den graphics—Brazilian women entering t workforce who need cosmetics a young Mexicans living with their pare who want to buy their own homes—fa both companies, he says. What's mo the many IPOs are a sign of improvi market conditions.

Latin American stocks have been o tear for some time, but the big recov story overseas this quarter is Jap "We're finally getting close to the end deflation in Japan," says manager Br Lynn of the $2.4 billion Janus Overs Fund. "Real estate prices and rents h finally started to move up." Moreover, c sumer confidence is strong and Japan banks, which have been troubled for yea have finally cleaned up the problem lo on their balance sheets, he says.

How the Big Funds Fared

FUND	ASSETS (BILLIONS)	TOTAL RETURN*
Vanguard 500 Index Investor	$74.4	2.44%
Growth Fund of America A	67.8	5.89
Investment Co. of America A	66.1	3.57
Washington Mutual Investors A	63.2	1.24
Fidelity Magellan	53.9	2.55
Fidelity Contrafund	53.4	6.88
Dodge & Cox Stock	48.6	4.19
Income Fund of America A	47.4	0.93
Standard & Poor's Depositary Rcpts.	47.2	2.01
Capital Income Builder A	41.2	2.73
EuroPacific Growth A	40.3	11.11
Fidelity Low Priced Stock	37.3	3.35
Capital World Growth & Income A	35.7	8.09
New Perspective A	34.6	7.81
American Balanced A	32.5	0.58
Vanguard 500 Index Admiral	31.5	2.46
Fidelity Growth & Income	31.1	1.31
Vanguard Total Stock Mkt. Idx.	30.5	2.77
Vanguard Windsor II Investor	29.7	3.10
Fidelity Diversified International	29.7	9.83

*Annualized, plus reinvestment of dividends and capital gains, through [illegible]

Data: [illegible]

kimpy Returns for Most Bond Funds

ATEGORY	TOTAL RETURN*	CATEGORY	TOTAL RETURN*
nerging Markets Bond	3.58%	Muni. National Long	-0.26%
gh Yield	1.17	Muni. New York Long	-0.26
ultisector	0.72	Muni. Single-State Interm.	-0.27
xable Money Market	0.46	Muni. Calif. Interm.	-0.28
trashort	0.37	Muni. National Interm.	-0.29
x-Free Money Market	0.30	Muni. New York Interm.	-0.31
uni. High Yield	0.27	Intermediate (General)	-0.50
ternational Bond	0.17	Intermediate Government	-0.52
uni Short	0.15	Long Government	-1.08
ort (General)	0.13		
uni. Calif. Long	-0.08	Taxable Bond Funds	0.16
ort Government	-0.12	All Bond Funds	0.00
uni. Single-State Long	-0.24%	All Tax-Free Bonds	-0.21

preciation plus reinvestment of dividends and capital gains before taxes. July 1-Sept. 27, 2005. **Data:** Standard & Poor's

merging-market bond funds did well quarter, up 3.6% on average, for the e reason as emerging-market stocks. commodity prices rose, money from developed world flooded such comlity-rich countries as Russia and zil, strengthening their fiscal balance ts and the credit quality of their ds. Consequently, investors became fearful of owning them. "Many sod emerging markets have long since rged," says manager Bill Gross, who sees some $500 billion as head of CO Funds bond department. "Russia has an investment-grade credit ratand with oil where it is right now, bably more money in the bank than U.S."

ross favors emerging-market debt little else. Because yield spreads have owed substantially between corpo- bonds and Treasuries, and because U.S. economy is on shaky ground oil shocks and hurricanes, he thinks stors are better off with funds that Treasury Inflation-Protected Securi- (TIPS) and short-term bond funds buy mortgage-backed securities. The other category he favors is municipal- l funds, where yields can be well e Treasuries once you adjust for taxays Gross: "In this kind of an envinent, that's a slam dunk."

ross thinks high-yield bonds are too y valued right now, but the extra they provide tends to make them sensitive to interest rate increases. (In parison to other bonds, when rates junk yields still look attractive.) For reason high-yield bond funds gained on average this quarter, the best performers in the group being those which invested in the lowest quality bonds with the greatest payouts. Top performer SunAmerica High Yield Bond Fund, up 3.8%, has 35% of its assets in "distressed debt" on the verge of bankruptcy or in bankruptcy proceedings.

This may be a high-risk area, but the fund is sub-advised by insurance giant AIG, which has a 25-member managerial and analyst team that pores over the balance sheets of distressed companies to see if they can avoid or survive bankruptcy. Right now, co-manager Greg Braun says there are still some attractive opportunities in the airline sector, which has been suffering terribly from oil increases.

Surprisingly, hurricanes Katrina and Rita have yet to make an impact on the muni-bond market. In Louisiana and Mississippi, "insurance companies have been making the interest payments on most of the debt," says Thomas Fetter, who oversees $13 billion in muni-bond funds at Eaton Vance. "There hasn't been a lot of trading of the bonds in the region. People are just holding them to find out more information." In the long-term, Fetter thinks all of the aid flowing into the region will be a positive. "Congress has set aside everything on its agenda this fall to focus only on Louisiana and Mississippi," says Fetter.

Given that most funds would only have relatively small holdings in this region, muni fund investors don't need to worry about hurricane fallout. Diversification mitigates the financial damage from such events, and diversification is something mutual funds do best. ■

Banking from the heart.
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Go East, Fund Investor

Lots of cash is flowing into Japan funds. Here's how to place your bets wisely. **BY LAUREN YOUNG**

LIKE A BROKEN RECORD, investment strategists and Asian experts have been declaring a new bull market in Japanese stocks over and over again for the better part of a decade. Now a rebound—finally—seems to be taking hold at Japan Inc., thanks to major corporate reforms. While the stock market has enjoyed upward momentum in recent months—as well as a nice bounce on the heels of Prime Minister Junichiro Koizumi's recent reelection—the Nikkei 225 index, at 13,393, is still a fraction of the nearly 40,000 it reached at the end of 1989.

That's why investors should give the world's second-largest economy serious consideration over the longer-term. Real estate prices, particularly in central Tokyo, are up for the first time in more than a decade. Wholesale prices have been rising for the past 18 months, signaling the beginning of an end to a long, difficult deflationary period. Japanese banks, which have been troubled for

years, have cleaned up the problem loans on their balance sheets. Corporate profits are at record levels, with bellwethers such as Mitsubishi Electric Corp. raising their estimates for the coming fiscal year.

Japanese companies are starting to become more shareholder-friendly. Corporate governance is improving. In addition, many companies are paying meatier dividends for the first time or increasing payouts that had been paltry in the past. The dividend yield on Japanese stocks is about 1.5%, not that far behind that of companies in the Standard & Poor's 500-stock index.

The Japanese consumer is in better shape, with consumer confidence on the rise. "Incomes have been steady, bonuses are increasing," says George Greig, manager of the William Blair International Growth Fund. A stronger yen—it's up almost 10% against the U.S. dollar in 2005—gives Japanese households more buying power.

To capitalize on these improving economic trends, Br Lynn, manager of the Janus Overs Fund, owns shares of banking gi Mizuho Financial Group and office-sp agent Mitsubishi Estate. Meanwh William Blair's Greig likes retailers, cluding Yamada Denki, an electron chain, as well as Komeri, a home-produ retailer. With companies finally replac obsolete equipment and upgrading fac ties after a 20-year lull, Lynette Schroe manager of the Driehaus Internatio Discovery fund, is betting on machine t manufacturer Okuma and constructi machinery giant Komatsu.

Although it's hard to find many be right now, there are risks. Japan still pends on a strong U.S. economy to prov a big market for its high-end goods such DVD recorders and luxury cars. A dov turn in China could also leave Japan's porting sector exposed. While many forms are under way, "you don't see a lo fast change," says Andrew Johnsen, a fu manager at Boston Co. Asset Managem

RETAIL DETAIL

THE RISKS ASIDE, lots of new mone heading East. U.S. investors have b putting record sums into funds that vest in Japan—$1.3 billion since mid- gust, according to AMG Data Servi Funds are an easier way to invest Japan than trying to build a portf stock by stock. Stick to a fund with a s soned manager, below-average expen and good performance (table). Matthews Japan Fund, for instance, eran manager Mark Headley is bett on increased consumer spending. A he's been stocking up on financial co panies. "There are very signific growth opportunities to bring be services to the long-ignored aver Japanese citizen," Headley says.

Another option for investors is a l cost exchange-traded fund which tra major Japanese equity indexes, s as iShares MSCI Japan Index or V guard Pacific Stock VIPERs. (The Pac stock fund is about 73% invested Japanese stocks.)

Well-known Asia investor Marc Fa is one of the biggest bulls. He predicts Nikkei could rise by as much as 40% three years. Given the run-up in the p few weeks, there's no need to rush "We believe the market is overheate the short term," says Citigroup strate Tsutomu Fujita, who is more bullish the long term. Since investors have b waiting for what seems like an eternity Japan to bounce back, a few more we shouldn't make much difference. ■

Zooming In on Japan

These mutual funds specializing in Japanese stocks have had the same managers for the past three years and low expenses

FUND / SYMBOL	TOTAL RETURN* YTD	TOTAL RETURN* THREE YEAR
Fidelity Japan FJPNX	15.4%	19.7%
Fidelity Japan Smaller Cos. FJSCX	11.8	26.1
Japan S SJPNX	3.8	21.2
Matthews Japan MJFOX	3.0	22.0
T. Rowe Price Japan PRJPX	15.8	21.3
Rydex Large Cap Japan RYJPX	4.5	14.9
Vanguard Pacific Stock Index VPACX	10.7	21.1

*Annualized, plus reinvestment of dividends and capital gains before taxes

Data: [illegible]

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EDITED BY TODDI GUTNER

TRAVEL

MATCHMAKER, MATCHMAKER, FIND ME A SEAT

AIRLINE FLIGHTS ARE one of the few situations where you find yourself wedged against a total stranger for hours at a time. It might as well be someone you like. With that in mind, a new Web site, **AirTroductions.com,** aims to match like-minded fliers for business networking, book discussions, romance—whatever it is you want from a seatmate.

To get started, you'll need to fill out a short form that includes your bio as well as preferences on topics such as hotels (Holiday Inn or Four Seasons?) and clothes (Prada or Levi's?). Once you have a ticket, enter your flight data to see who is signed up on the site for the same flight. You'll pay $5 if you contact anyone. Then you'll need to ask the airline to put you in adjoining seats. Less than 1,000 people are registered, so chances are slim you'll find someone on your flight. But if the idea catches on, it may be the end of the seatmate from hell. *–Lauren Young*

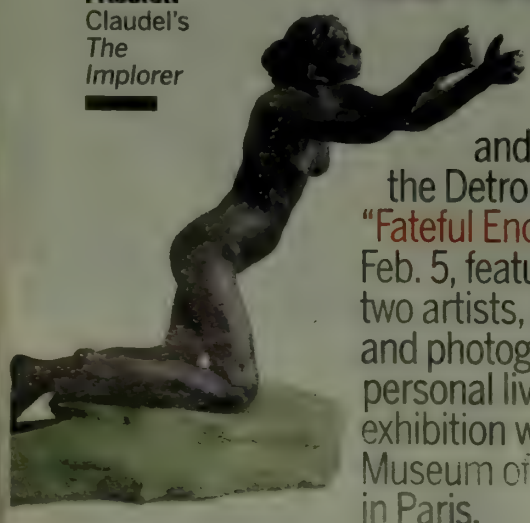
TAXES

Lock Up That Trus

IF YOU'VE GOT A charitable remainder trust (CRT) or are planning to set one up careful: A recent Internal Revenue Service ruling may put the generous tax br that come with a CRT at risk. The problem? At least 18 states—including Virgi Michigan, and New Jersey—allow spouses to override your will and instead ta a set share of your estate, including the CRT. The best way to protect the trust tax benefits? Get your spouse to sign a legal document waiving his or her righ the portion of the trust that's designated for charity—and that earned you a charitable deduction.

For trusts launched after June 27, there's another wrinkle: Your spouse must that waiver within six months of the date your trust's tax return is due for the ye which you either marry or move to a state that lets spouses tap these trusts. Mis that deadline, and you lose the trust's charitable deduction, warns Don Weigand Los Angeles-based managing director at JPMorgan Private Bank. Moreover, you trust will owe tax on all its profits, he adds. *–Anne Ter*

TIME OFF

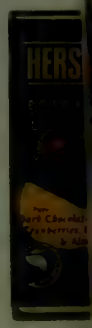


PASSION Claudel's *The Implorer*

FROM THE BRIEF but passionate late 19th century love affair of artists Auguste Rodin and Camille Claudel came great sculpture—and, now, an intriguing art exhibit at the Detroit Institute of Arts (dia.org). "Fateful Encounter," running from Oct. 9 to Feb. 5, features more than 130 works by the two artists, along with more than 50 letters and photographs that show how their personal lives influenced their art. The exhibition was organized by Quebec City's Museum of Fine Arts with the Rodin Museum in Paris. *–Kathleen Kerwin*

FOOD

IS CHOCOLATE GOOD FOR YOU?



WITH STUDIES suggesting the antioxidants in dark chocolate can fight diseases, confectioners want you to think it's like broccoli. Now, **Hershey's** is launching **Extra Dark** bars whose wrappers feature a "Natural Source of Flavanol Antioxidants" seal. But dark chocolate often has high sugar and fat, so "it's not like broccoli, which you can eat tw a day," says Jeffrey Blumberg, a Tufts University nutrition professor.

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BY GENE G. MARCIAL

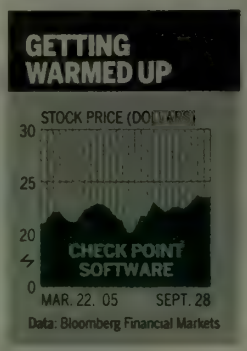
WEB SECURITY WORRIES ARE BOOSTING CHECK POINT SOFTWAR

NUVASIVE'S SURGICAL SUPPLIES ARE OUTGUNNING BIG RIVALS.

A POWER PACK TO JUICE UP GADGETS ON THE GO, FROM MEDIS.

Check Out Check Point

CHECK POINT SOFTWARE Technologies (CHKP) is small potatoes compared with Cisco, Symantec, or Juniper Networks, but it's emerging as the pure-play leader in red-hot Internet security. Joseph Phillips of Redwood/Technimentals Research says Check Point's strength is in how well its products shield networks of any size and complexity from hackers. Check Point makes customized systems—including virtual private networks (VPNs), firewalls, and intranet/extranet security—for small businesses, service providers, and large enterprise networks. The rise in Internet traffic, he notes, has increased networks' vulnerability—and boosted demand for security. The stock, now at 23, is worth 30, says Phillips, based on earnings, cash flow, and favorable margins. Jonathan Rudy of Standard & Poor's, who tags the stock a buy, likes Check Point's "strong growth in an expanding market." The global recovery in info-tech spending, he says, will continue to lift earnings. Check Point had remained "very profitable throughout the tech downturn last year," notes Rudy, who sees profits of $1.28 a share in 2005 and $1.41 in 2006, up from 95¢ in 2004.

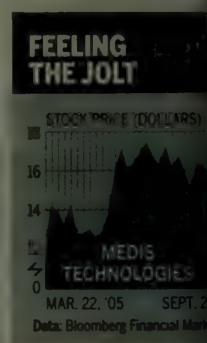


Sitting Up Straight At NuVasive

MEDICAL DEVICE MAKER NuVasive (NUVA) has been outrunning its big rivals. Shares of the tiny maker of minimally invasive surgical tools and implants for treating spine disorders bolted from 12 in March to 20 in late August. It has since dropped to 18, but the drop is a chance to buy, say some pros. Orthopedic makers saw their shares fall because of rumors that price-cutting might be on the way. Prices have yet to decline. Ben Andrew of William Blair, which has done banking for NuVasive and owns shares, notes that industry competition is stiff. Nevertheless, NuVasive is posting strong revenue growth—close to 70% this year, he says. Trading at 4.5 times his estimated 2006 sales of $93 million, the stock is a compelling investment, says Andrew. He sees NuVasive in the black in 2006, with earnings of 14¢ a share, vs. a 42¢ loss in 2005. Matt Arens of Kopp Investment Advisors, with a 7.5% stake, says NuVasive does well against biggies like Medtronics because of its "innovative products," such as Neodisc, which permits movement in patients soon after undergoing spinal surgery. Ken Lauden of Cottonwood Investments notes that many NuVasive execs are ex-Medtronics officers. He bought shares last year at 10 and sold at 20. "I plan to get back in," he says.

A Real Charge from Medis Technologies

MEDIS TECHNOLOGIES (MDTL) may have a big winner: a disposable, portable Power Pack to recharge cell phones, video games, iPods, and the like. Users won't have to look for electrical plugs to charge their gadgets, says Medis CEO Robert Lifton. Medis is in t with big mobile-phone outfits that are trying out the Powe Pack, he says. General Dynamics has successfully tested it its Itronix' tablet GoBook, says Lifton, and has shown inter in emergency recharging for its wireless and military phon Power Pack production will start in the first quarter of 200 Medis' Israeli plant, with a capacity of 20,000 units a mont By 2007, full production will begin in Switzerland—for 1.5 million units a month. Medis has signed up Celestica and Ismeca Europe Automation to run the assembly line. The units will then cost $4.50 apiece to make and will be sold to vendors like phone companies for about $7.50, Lifton adds. The Power Pack can charge up to 20 hours of "talk time," and when the gadget is off, the power lasts up to eight weeks. Medis has inked a $57 million order from ASE International, a distributor to drugstores and other retailers. Otis Bradly of Gilford Securities rates Medis—up from 12 a share in May to 17 now—a buy. It will be in the red until 2007, when he expect to earn $1.43 a share. Among big holders: John Hancock Advisers, Citigroup, and Goldman Sachs. ■



BusinessWeek online Gene Marcial's Inside Wall Street is posted a businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

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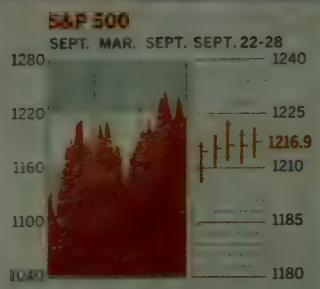
STOCKS



COMMENTARY

Mixed messages from the economy had little effect on stocks. On the downside, leading indicators, along with consumer confidence, fell, while on the upside, durable-goods orders rose and real estate remained red hot. Traders, however, kept to the sidelines and volume was light. A positive: Boeing shares surged on rising jet orders and news of its union settlement.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	SEPT. 28	WEEK % CHANGE	YEAR TO DATE % CHANGE	LAST 12 MONTHS % CHANGE
S&P 500	1216.9	0.6	0.4	9.6
Dow Jones Industrials	10,473.1	0.9	-2.9	3.9
NASDAQ Composite	2115.4	0.4	-2.8	13.1
S&P MidCap 400	702.7	0.9	5.9	19.8
S&P SmallCap 600	345.0	1.3	4.9	19.9
DJ Wilshire 5000	12,143.6	0.6	1.6	12.1
SECTORS				
BusinessWeek 50*	748.3	0.5	6.2	15.8
BW Info Tech 100**	363.5	0.1	-2.6	12.7
S&P/BARRA Growth	581.9	0.6	0.0	8.4
S&P/BARRA Value	630.8	0.5	0.8	10.8
S&P Energy	407.6	0.2	41.3	46.6
S&P Financials	391.5	0.1	-4.8	2.3
S&P REIT	149.0	-0.3	3.1	17.9
S&P Transportation	219.9	2.2	-8.9	6.3
S&P Utilities	169.0	1.3	19.3	32.6
GSTI Internet	173.9	1.3	-2.5	19.2
PSE Technology	803.2	0.3	3.1	20.2

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	SEPT. 28	WEEK % CHANGE	YEAR TO DATE % CHANGE
S&P Euro Plus (U.S. Dollar)	1451.7	0.9	3.9
London (FT-SE 100)	5494.8	2.3	14.1
Paris (CAC 40)	4699.6	0.9	20.4
Frankfurt (DAX)	5048.7	3.6	18.6
Tokyo (NIKKEI 225)	13,435.9	1.8	16.9
Hong Kong (Hang Seng)	15,221.5	0.0	7.0
Toronto (S&P/TSX Composite)	11,042.3	0.8	19.4
Mexico City (IPC)	15,869.3	0.9	22.8

FUNDAMENTALS	SEPT. 27	WEEK AGO	YE
S&P 500 Dividend Yield	2.05%	2.04%	1.
S&P 500 P/E Ratio (Trailing 12 mos.)	19.0	19.1	19
S&P 500 P/E Ratio (Next 12 mos.)*	14.9	15.0	16
First Call Earnings Revision*	0.55%	1.28%	-0.6

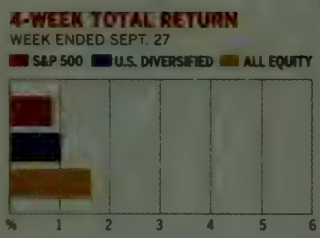
*First Call

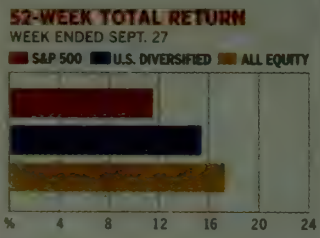
TECHNICAL INDICATORS	SEPT. 27	WEEK AGO	RE
S&P 500 200-day average	1199.6	1198.8	Pos
Stocks above 200-day average	57.0%	57.0%	Ne
Options: Put/call ratio	0.85	0.73	Pos
Insiders: Vickers NYSE Sell/buy ratio	4.94	5.24	Nega

BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Oil & Gas Refining	28.3	Oil & Gas Refining	128.0
Divsfd. Metals & Mining	24.7	Oil & Gas Exploration	76.3
Gold Mining	21.3	Fertilizers & Ag. Chems.	66.0
Oil & Gas Exploration	17.2	Managed Health Care	63.9
Oil & Gas Storage	12.9	Oil & Gas Drilling	56.3

WORST-PERFORMING GROUPS	LAST MONTH %		LA MO
Home Furnishings	-17.0	IT Consulting	-
Educational Services	-13.4	Home Furnishings	-
Auto Parts & Equipment	-12.8	Automobiles	-
Aluminum	-11.8	Aluminum	-
Specialized Cnsmr. Serv.	-10.2	Insurance Brokers	-

MUTUAL FUNDS





Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Precious Metals	15.1	Latin America	74.3
Latin America	15.0	Natural Resources	50.2
Diversified Emerg. Mkts.	8.1	Diversified Emerg. Mkts.	43.3
Natural Resources	7.7	Utilities	32.3
LAGGARDS		**LAGGARDS**	
Miscellaneous	0.3	Financial	8.8
Real Estate	0.3	Domestic Hybrid	9.2
Financial	0.4	Large-cap Blend	11.4
Domestic Hybrid	0.5	Miscellaneous	11.8

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
ProFunds Precs. Mtls. Inv.	26.5	Guinness Atkn. Gl. Energy	87.7
Midas	19.9	T. Rowe Price Lat. Am.	81.2
iShares MSCI Brazil Idx.	18.1	iShares MSCI Brazil Idx.	80.4
Fidelity Select Gold	17.9	iShares S&P L. Am. 40 Idx.	79.1
LAGGARDS		**LAGGARDS**	
Turnaround	-6.0	Ameritor Investment	-54.2
ProFunds. Semicdr. Inv.	-5.3	ProFds. USh. Mid Cap Inv.	-31.3
ProFunds Cnsmr. Svcs. Inv.	-3.9	ProFds. USh. Sm. Cap Inv.	-29.1
Seligman Sm. Cap Val. A	-3.9	Rydex Dyn. Vent. 100 H	-22.1

INTEREST RATES

KEY RATES	SEPT. 28	WEEK AGO	YEA
Money Market Funds	3.21%	3.15%	1.1
90-Day Treasury Bills	3.45	3.39	1.7
2-Year Treasury Notes	4.00	3.92	2.5
10-Year Treasury Notes	4.26	4.17	4.0
30-Year Treasury Bonds	4.50	4.46	4.8
30-Year Fixed Mortgage†	5.83	5.72	5.5

†BanxQuote.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BO
General Obligations	3.74%	4.4
Taxable Equivalent	5.34	6.3
Insured Revenue Bonds	3.89	4.6
Taxable Equivalent	5.56	6.6

THE WEEK AHEAD

PURCHASING MANAGERS' INDEX *Monday, Oct. 3, 10 a.m. EDT* » The Institute for Supply Management's factory activity index is forecast to have slipped to 51% in September. That's according to the median forecast of economists surveyed by Action Economics LLC. The August index eased to 53.6%.

CONSTRUCTION SPENDING *Monday, Oct. 3, 10 a.m. EDT* » In August building outlays probably increased 0.4%, after holding steady during July.

FACTORY INVENTORIES *Tuesday, Oct. 4, 10 a.m. EDT* » Manufacturing inventories most likely dropped 0.3% in August, following a 0.5% gain in July.

EMPLOYMENT *Friday, Oct. 7, 8:30 a.m. EDT* » September nonfarm payrolls are forecast to have grown by just 20,000, largely the result of Hurricane Katrina. August payrolls rose by 169,000. Factories probably shrank by 20,000 jobs after declining by 14,000 workers in the previous month. The marked slowdown in new jobs will probably result in a jobless rate of 5.1%, up from 4.9% in August.

INSTALLMENT CREDIT *Friday, Oct. 7, 3 p.m. EDT* » Consumers most likely added $5.3 billion in debt during August. Installment credit increased $4.4 billion in July.

The BusinessWeek production inc improved to 255.5 during the we ended Sept. 17, an 11.8% increa from a year ago. Before calculation the four-week moving average, t index stood at 258.2.

BusinessWeek onlin

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/extra.

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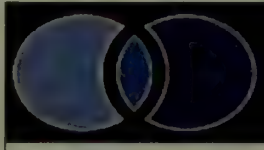

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An Inferno Waiting to Happen

A CRACK IN THE EDGE OF THE WORLD America and the Great California Earthquake of 1906
By Simon Winchester; HarperCollins; 462 pp; $27.95

In *A Crack in the Edge of the World: America and the Great California Earthquake of 1906*, best-selling author Simon Winchester comes up with a solid concept for an historical thriller: retelling the riveting story of the San Francisco earthquake and fire in the context of new breakthroughs in the field of geology.

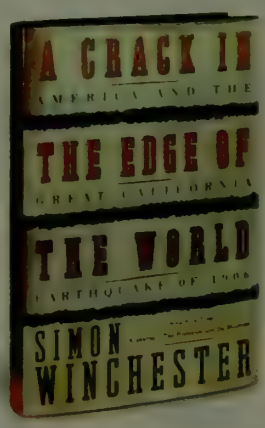
In the past 40 years, Winchester tells us, the Old Geology, with its focus on rocks and fossils, has given way to a New Geology that sees the planet as "one entire and immense system." The theory's heart is plate tectonics, which presents the earth's exterior as if it were a giant jigsaw puzzle of rigid plates whose interactions drive most major geologic activity, including the creation of oceans, mountains, and earthquakes.

But like two plates grinding into one another, Winchester's approach produces some unfortunate results. Most annoying, he turns literary foreplay into a maddening tease. It's not until page 201 that he begins to tell the horrific tale of how the largest city in the Western U.S. was destroyed by an earthquake-triggered fire that burned uncontrollably for three days. Reading chapter after chapter, I kept thinking, O.K., here's where the earthquake is going to strike. But Winchester postpones the main event with a tortuous chronicle of the geological evolution of the U.S., California, and the San Andreas fault. Moreover, he fails to produce a central character or theme that could have fused his geological musings with the story of the quake.

Still, if you make it through the first half of the book, the second half is enjoyable. In two entertaining chapters, Winchester chronicles the genesis and "exuberant, almost irrational" growth of the city, beginning with the 1848 gold rush. Most of the arrivals pitched tents on the slopes of the city, and the oil lanterns within created an assemblage that looked from the crowded harbor "like an amphitheatre of fire." The housing shortage was so acute that a few enterprising folks rammed ships into the muddy shoreline and refashioned them into hotels and prisons. The promise of riches drew shady characters from all over the world. Winchester reports that the word hoodlum is derived, some say, from a racist cry of "huddle 'em," a signal for local mobs to harass Chinese immigrants.

When Winchester turns to the earthquake, echoes of Hurricane Katrina abound. For years fire chief Dennis Sullivan had demanded a saltwater firefighting system and freshwater cisterns that could help control a big blaze. And October, 1905, the National Board of Fire Underwriters declared San Francisco's water system to be in such poor shape that it would not be able to halt a major conflagratio But like the many unheeded calls to shore up New Orleans defenses against floods, these warnings were disregarded. Seven months later the cautions proved tragically prescien

The earthquake struck the city at 5:12 in the morning o Apr. 18, 1906. It thundered through the streets like a roller coaster of death, with the entire surface of the earth and everything on top of it rising and falling, rising and falling, an "unstoppable tsunami of rock and brick and cement an stone." Winchester quotes one cop's report: "The building around and about me began to tumble and fall kept me pretty busy for a while dodging bricks." Toppling chimneys were lethal weapons, killing many as they slept, including the fire chief.



The horror lasted all of 48 seconds, and then hell let loose. Moments after the shaking stopp broken gas pipes, fuel tanks, and chimney coals ignited the city. Within 12 hours, half of San Francisco's heart was torched. On Apr. 21 the fi finally burned themselves out. When the smoke cleared, 3,000 people were dead, and half of the city's 400,000 residents were homeless.

The city ultimately recovered from the trage Unfortunately, Winchester does little with this of the story. Still, he makes interesting point that desp the rebuilding, "San Francisco's crown began t slip immediately after the disaster of 1906. And the c has never regained its stat nor will it ever." The torch supremacy passed to Los Angeles. San Francisco did learn some lessons, thoug Stronger building codes w written. And architects be using reinforced concrete and steel skeletons. The city has suffered a catastrophic fire since.

As in New Orleans, calls to shore up San Francisco's defenses had been ignored

In the end, *A Crack in the Edge of the World* is less successful than previous Winchester efforts, such as *The Professor and the Madman*. As he has in the past, the autho marshals a trove of arcane research to spin a memorable t But this time there are a lot of rocks to dig through before reader hits pay dirt. ■

–By Spencer E.

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IdeasViewpoint

BY JEFFREY E. GARTEN

The Pirates of Global Trade

On Aug. 22, Acting Assistant Attorney General John C. Richter announced the arrest of 59 people in 11 U.S. cities for their participation in a vast international criminal enterprise. The group, said Richter, was a one-stop shop for trafficking in counterfeit currency, fake pharmaceuticals, forged postal stamps, illegal narcotics, and weapons such as rocket launchers. Th operation was one of Washington's biggest global busts in recent years, and Richter implied more were in the works.

Illegal trade is not new, of course. But it remains a tumor on the global economy that could easily metastasize into a worldwide cancer that corrodes law and order, leads to other crimes and violence, and even finances terrorism. Unfortunately, governments here and abroad increasingly are no match for today's complex and sophisticated criminal organizations.

The extent of money laundering can be seen as a rough proxy for total global contraband activity. It has grown to 10 times its 1990 level, to well over $1 trillion today—equivalent to about 10% of legitimate global trade. Most of this is narcotics smuggling, which comes to some $900 billion annually. Illicit sales of weapons amounts to $10 billion per year; toxic waste dumping across borders, $12 billion; smuggling of aliens, including women and children destined for sexual exploitation, $7 billion; bootlegged movies, $3 billion; stolen art, $3 billion. (These are all gross estimates from official sources and trade associations.)

A new book, *Illicit*, calls for a global assault on contraband traffickers

IN A FEW WEEKS the most comprehensive and thoughtful work on this subject to date will be released: a book by Moisés Naím, editor of *Foreign Policy* magazine, titled *Illicit: How Smugglers, Traffickers, and Copycats Are Hijacking the Global Economy*. In an interview, Naím explained to me why illicit trade is out of control and the obstacles governments face in combating it. His major point is that globe-spanning criminal networks are organized in decentralized, cell-like structures that make them as hard to eliminate as al Qaeda. Moreover, they are using cutting-edge transportation technology, in addition to satellite global positioning systems, that give them the logistical flexibility of a FedEx or Wal-Mart Stores—and make them increasingly difficult to track.

Among the obvious measures needed are better coordination among law-enforcement agencies and more extensive use of up-to-date surveillance technology. But more radical strategies are required. For instance, Naím is right when he says it's futile to try to shut off the supply o drugs or illegal immigrants without simultaneously either regulating or curtailing demand for them among consum or employers. He also correctly argues that it's insufficien to have law-enforcement officials approach illicit trade in compartmentalized way—zeroing in, for example, on drug or weapons, the exploitation of women and children, or money laundering. Naím advocates instead a more integrated strategy to better combat the capability of criminal gangs to act as multinational enterprises that switch back and forth from one "product" to another, depending on market opportunities.

But government and law-enforcement officials aren't th only ones who need to do more. Stephen E. Flynn, a senior fellow at the Council on Foreig Relations, believes that multinational corporations should be held accountable for ensuring that their extensive transportation systems don't become channels for smugglers. He proposes that such companies provide detailed schematics of their supply chains and X-rays of their cargo to government authoritie Companies would have to certify that they hav inspected for contraband, and governments would have the right to random audits of these claims. In return, regulators would guarantee that these same companies would not have to keep undergoing burdensome customs inspections at bord crossings. Some public-private cooperation of this kind is being mounted by the U.S. Customs Service and a number private companies to prevent the smuggling of goods attractive to terrorists, such as biochemicals. But these effor should be expanded beyond terror protection to include a wider range of products, such as counterfeit pharmaceutica

There is much more to do to prevent legitimate global flo of trade and money from being corrupted. But this will require a massive effort beyond what is now taking place. There's no time to waste.

Jeffrey E. Garten *is the Juan Trippe Professor at the Yale Scho of Management (jeffrey.garten@yale.edu).*

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If Katrina Teaches Us Nothing Else...

ANYONE WHO HAS watched the Republican-staged congressional hearings on the government's inadequate response to Hurricane Katrina has witnessed officials high and low playing the blame game. Nowhere was that more apparent than in the Sept. 27 testimony of Michael Brown, the former head of the Federal Emergency Management Agency. Congressmen of both parties hurled at Brown's head responsibility for poor coordination of first responders, inadequate communications, and the lack of crucial equipment to help storm victims. Brown, in turn, pointed his finger at the tardy response of New Orleans Mayor Ray Nagin, Louisiana Governor Kathleen Babineaux Blanco, and even his Bush Administration bosses for actions that led to the stranding of thousands in the flood-ravaged city.

It's tempting to dismiss the charges of someone whose sole qualification for the most important emergency-management job in the nation appears to have been his political connections (unless, of course, you believe heading the International Arabian Horse Assn. adequately prepares one to manage epic natural disasters). But that would be a mistake. Brown is right in at least one respect: There is no clear strategy for dealing with extraordinary disaster scenarios that can easily overwhelm local officials. And the lack of such unambiguous procedures can lead to chaos.

The lack of a clear strategy for handling disasters can lead to chaos

Currently state and local officials are responsible for responding to disasters such as blackouts, hurricanes, and the like. Even when assistance from Washington is requested, the feds still can't take on functions like using the military to maintain order or public safety. But with Katrina, this traditional separation of powers failed miserably. If Brown is correct in asserting that some state and local officials weren't up to the task of managing such a massive disruption once their command and communication systems imploded, then America may need new procedures or laws that spell out exactly when and how the federal government can assume more control in such situations.

Obviously this is sensitive stuff for states and localities, who are rightly wary of federal intrusion into their responsibilities. And it becomes even more touchy when partisan politics muddies the waters. (For example, both Nagin and Blanco are Democrats, while the federal government is controlled by Republicans.) That's exactly why this process of self-examination would have been better handled by an independent panel, such as the bipartisan 9-11 Commission that investigated the 2001 terror attacks. Instead we have an investigatory process boycotted by Democrats and manipulated by both sides for political ga

Despite this less-than-desirable structure, it's still possi for the panel to generate credible recommendations—especially on command procedures, communications standards, and levels of equipment that should be left beh by state National Guard units called into active duty. As Katrina vividly showed, these normally local issues can quickly morph into federal concerns. And that's exactly w a strong central government must take charge.

The Saudis' Energy 'Fix'

OIL PRICES, WHICH HAVE doubled in t past two years, have crimped consume spending, and they risk slowing globa growth. So Saudi Arabia's surprise mo to quickly secure some 110 drilling rig increase its oil production to as much as 12.5 millio barrels a day by 2009—a massive jump from the Kingdom's current 9.5 million bbl.-per-day output (page 38)—should be good news, right?

Wrong. Although painful, today's high energy prices ha provided the biggest inducement in a quarter-century for America to get serious about reducing its appetite for imported energy. The prospect of expanded Saudi capacity could kill that incentive and prolong energy dependence.

Not since the early 1980s, when oil reached its all-time high of $90 in today's dollars and precipitated a doubling the nation's energy efficiency, have we seen so many encouraging signs that high energy prices are trimming consumption. Sales of full-size sport-utility vehicles plung 29% in August after gas prices soared. Investments in alternative energy sources such as tar sands (expensive projects that only make financial sense when oil prices are high) are being seriously considered again. And on Sept. 2 President George W. Bush echoed Jimmy Carter when he called on Americans to curtail their energy use by driving l

Reducing energy consumption makes the economy less vulnerable to energy shocks from wars, hurricanes, or othe disasters. And such discipline on the part of the world's largest user nation goes a long way toward containing the pricing power of the oil cartel. High prices encourage companies and nations to spend more on energy research development—raising long-term efficiency whatever the price. Saudi production boosts could stall those measures.

To be sure, we're not advocating price shocks that could spark recession. But the global economy has easily withsto rising oil prices since 1998. So we think the long-term benefits of today's higher prices—more stable supplies, add efficiency, and energy security—balance the risks.

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BY TOM LOWRY (P.66)

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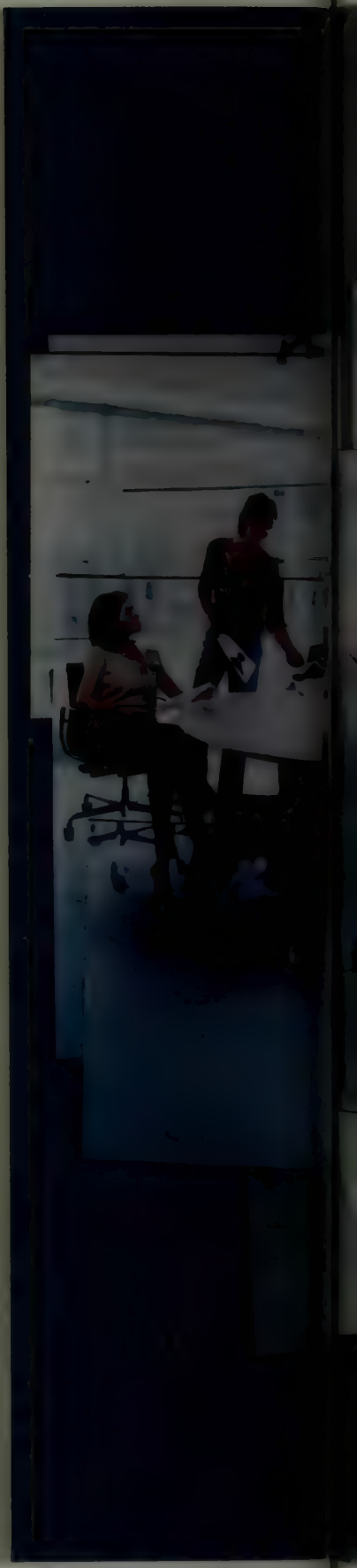

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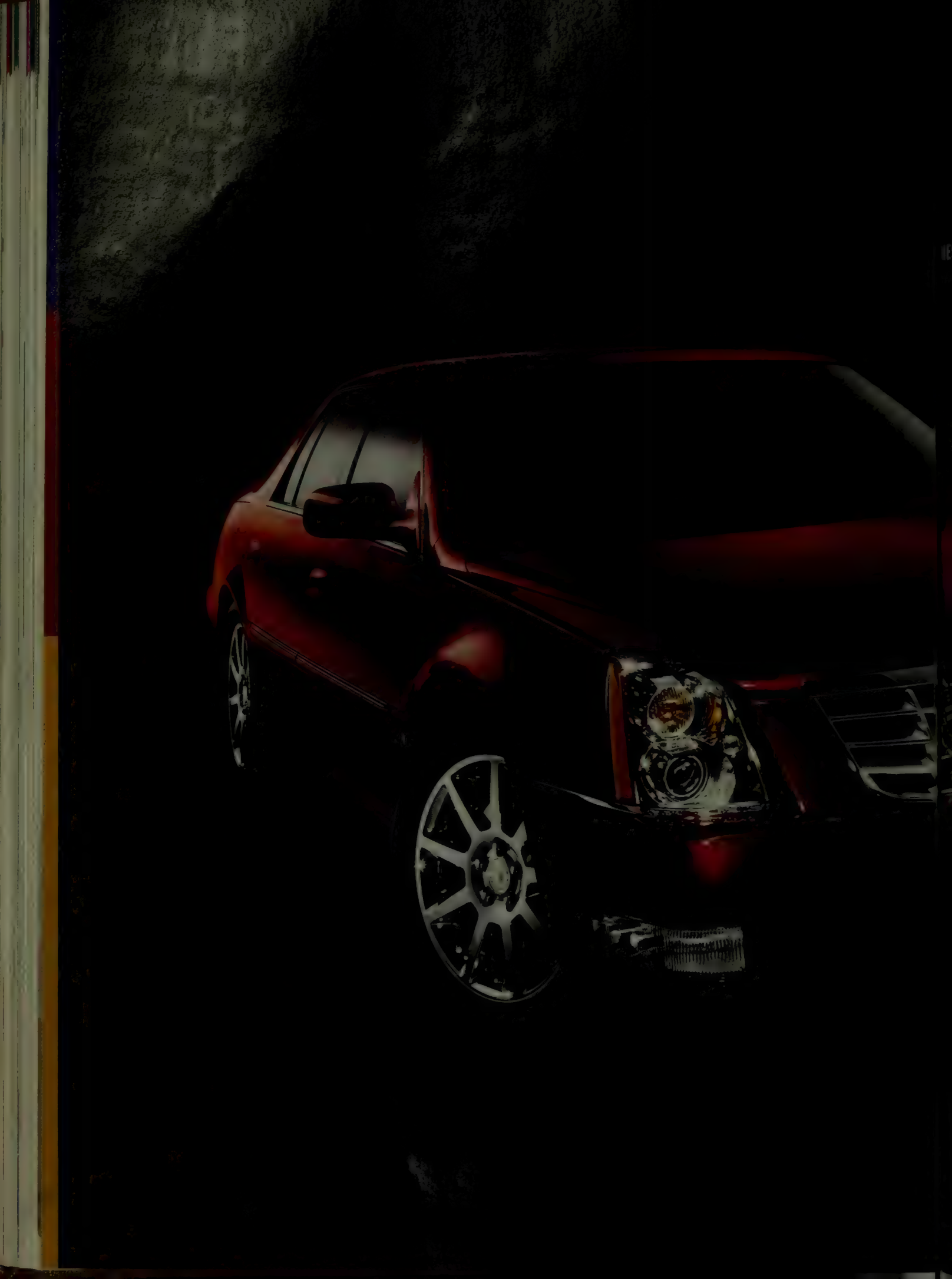

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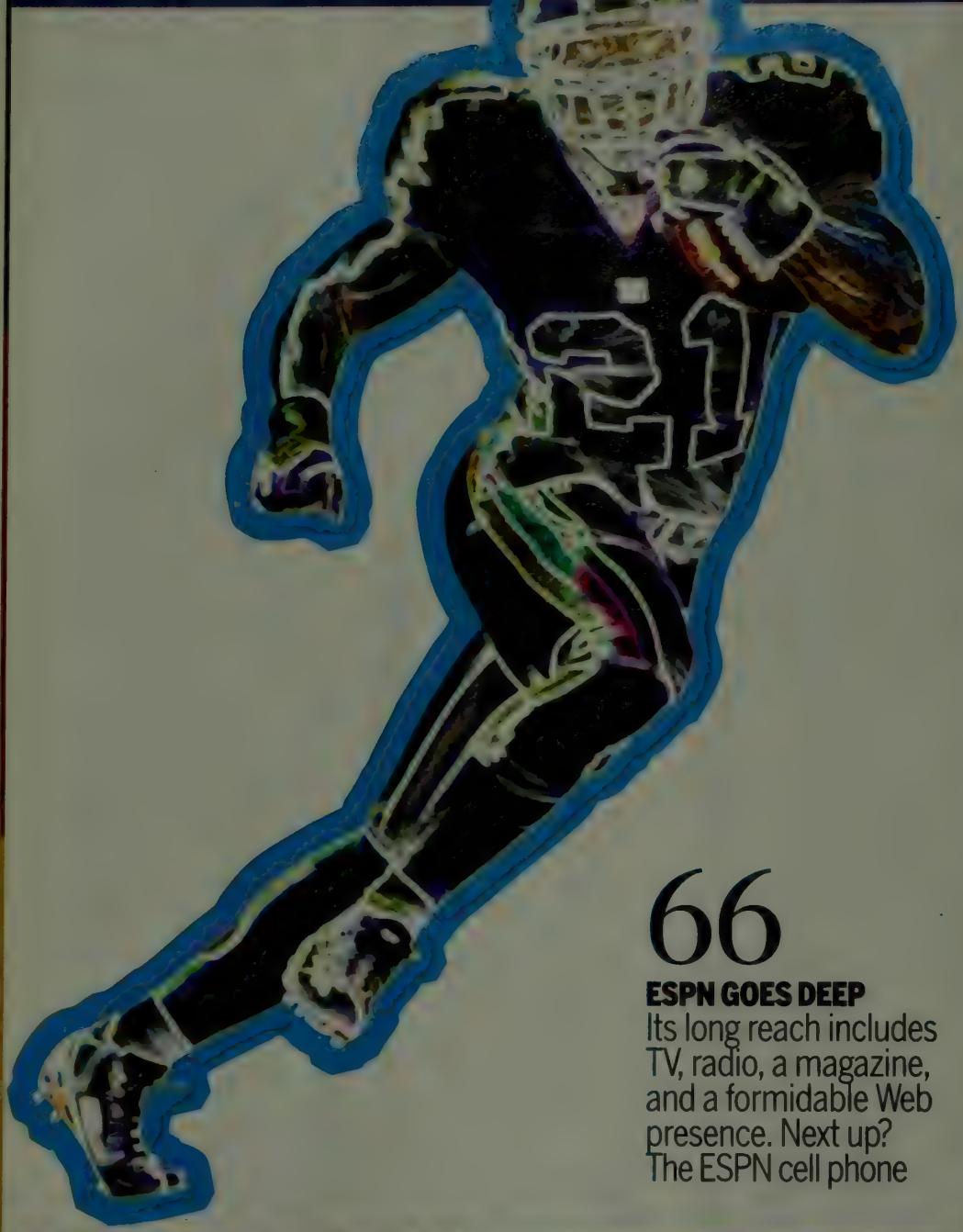
October 17, 2005



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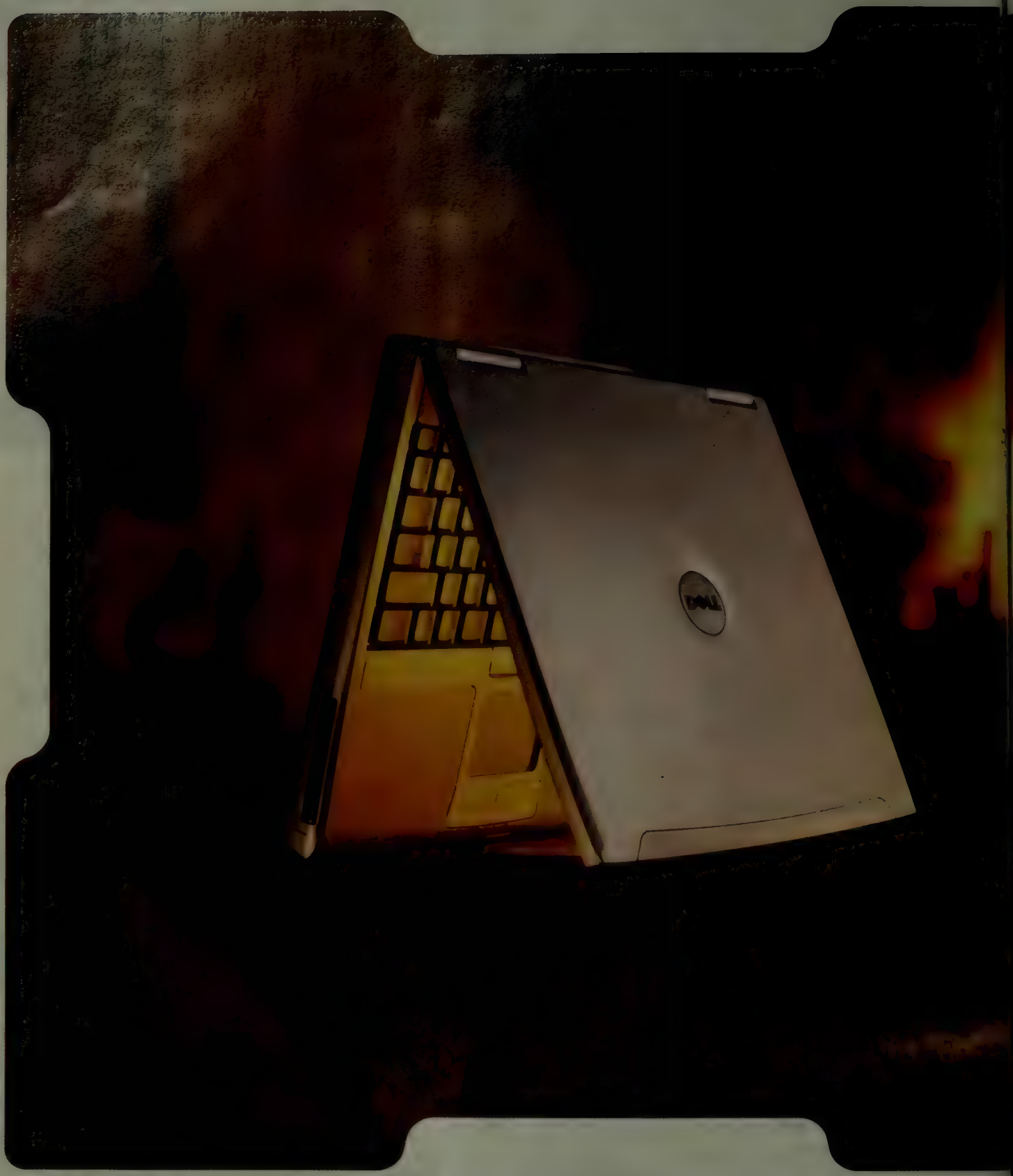

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- THE WALL STREET JOURNAL

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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

LIQUOR BRAND/PRICE*	OUR AWARD
TOP 3 GINS	
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Tanqueray No. Ten $26/750ml	Smoothest
Juniper Green Organic $26.50/750ml	Best Presentation

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Open Source: The Next Generation

This software movement is now sprouting an **entire ecosystem.** It's branching into not just mainstream business applications but also into the associated services that help make all the open-source pieces work. And **venture capitalists** are eager to help. They've pumped nearly $400 million into 50 open-source companies in the past 18 months. Also included in this Technology Special Report: A Q&A with Linux pioneer **Linus Torvalds** and a slide show of **promising open-source startups**

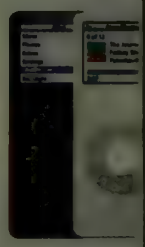
If the Housing Market Slumps, How Safe Are You?

You may be more exposed than you think, especially if your portfolio includes financial-services and consumer stocks. Better take a close look at your bond funds, too

SmallBiz Special Report: Passion for Business

Does your particular passion have what it takes to make it out of the basement and into the big time? Plus: Gadget hawker Ron Popeil's recipe for success and a slide show of the products he made famous

Why Apple Won't Up-Charge for Downloads



Record executives are clamoring for price flexibility in music downloads, but Steve Jobs is adamant that 99¢ per song is perfect

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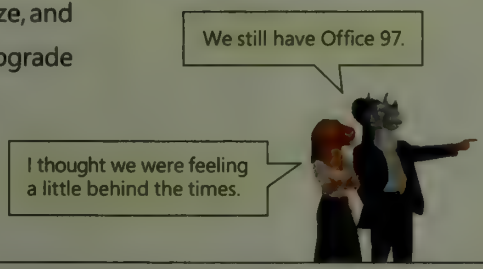

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JP Front

"To me, yes, it's worth the money."
–Gregory Olsen, entrepreneur and scientist, on spending a reported $20 million for a 10-day trip in space

TED BY CATHERINE ARNST

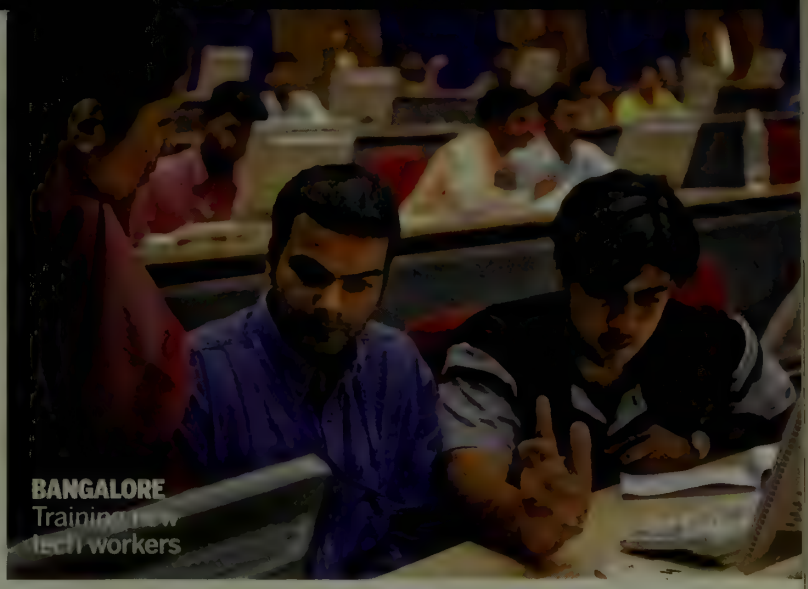
COND ACTS

ANK HE ELDER TATESMAN

TLING LAWSUITS hasn't ped insurance titan rice "Hank" Greenberg n continuing to enjoy spotlight. Even **merican national Group** ts for control of million shares l by Starr rnational Co., of three troversial ate entities trolled by enberg, the ed chief is y trying arve out a new role as grand old man of rance.

n recent weeks, enberg, 80, has spoken ut terrorism risk at a or conference, remarked on the industry's ability to absorb hurricanes, and publicly donated $1 million to Hurricane Katrina victims through the Starr Foundation he heads. That's in addition to discussing how he plans to invest the $17.7 billion pot that's now under dispute. Next up: a trip to China in the coming weeks to meet with the mayor of Shanghai and other high-ranking officials. Greenberg spokesman Howard Opinsky explains that his boss "remains a leading figure in the business community whose insights and experience are tapped regularly by business and political leaders." Opinsky adds that Greenberg "is actively pursuing new ventures." One venture, of course, will be tackling those legal woes. *–Diane Brady*

GREENBERG Still in the spotlight



BANGALORE Training new tech workers

OFFSHORING

Just the Bright Side, Thanks

AFTER HOLDING OFF for more than a year, the Commerce Dept. has quietly released a study of offshoring—the movement of white-collar jobs to low-wage countries. But it's not the even-handed assessment completed by staff analysts in June, 2004, after six months of research. The staff report was largely ditched, say outside experts who heard the staffers' views. Instead, these critics charge, Commerce political appointees put out a 12-page report that portrays offshoring as an unconditional boon to the U.S. economy. The Commerce Dept. did not respond to requests for comment.

Commerce has only released its final report to Rep. Frank Wolf (R-Va.) who ordered it up, but *BusinessWeek* has obtained a copy, as well as a slide show tied to the original research, presented by staffers at a conference last December.

The staff researchers' presentation gave both the pros and cons, comparing factors that favor U.S. high-tech job growth with those that favor offshoring. The official version dispenses with most of the disadvantages. Instead it points to pro-offshoring studies done by McKinsey Global Institute and uncritically cites data from a lobbying group that represents the U.S. subsidiaries of foreign companies. "No objective analysts, even if they were in favor of outsourcing, would write a report like this," says Ron Hira, a professor at Rochester Institute of Technology, who saw the December presentation. To see the slide show and official report, go to www.businessweek.com/extras. *–Aaron Bernstein*

E BIG PICTURE

TFEET'S compensation survey nd that MBAs expect a starting ary of $93,770, up from $88,840 in 2004. re's how offers in five industries compare:

ISULTING	$101,325*
ANCIAL SERVICES	$90,443
HNOLOGY	$86,053
ISUMER PRODUCTS/PHARMA	$84,184
PROFIT	$77,858

offers, excluding signing bonuses

Data: WetFeet 2005 Student Compensation Report

UP Front

DAYLIGHT SAVING

RESETTING CLOCKS MAY UPSET PCs

THE ENERGY BILL passed in August will extend daylight saving time by four weeks each year. Could that pose Y2K-like problems for business? Hillel Parness, a litigator at Brown Raysman Millstein Felder & Steiner LLP in New York, who has studied daylight saving time history, argues that every self-adjusting computer or other electronic device will be displaying the wrong time beginning on Mar. 11, 2007, unless steps are taken. He talked with Elizabeth Woyke.

Won't some of these glitches be minor?
Time accuracy on the video of your child's birthday party is probably not very important. But what about security cameras that record who enters a building when? Because the financial markets are international and time-sensitive, there could be serious implications. Prices depend on what time the trades come in. There have been recent investigations with mutual funds that looked at late trading and highlighted the importance of time accuracy.

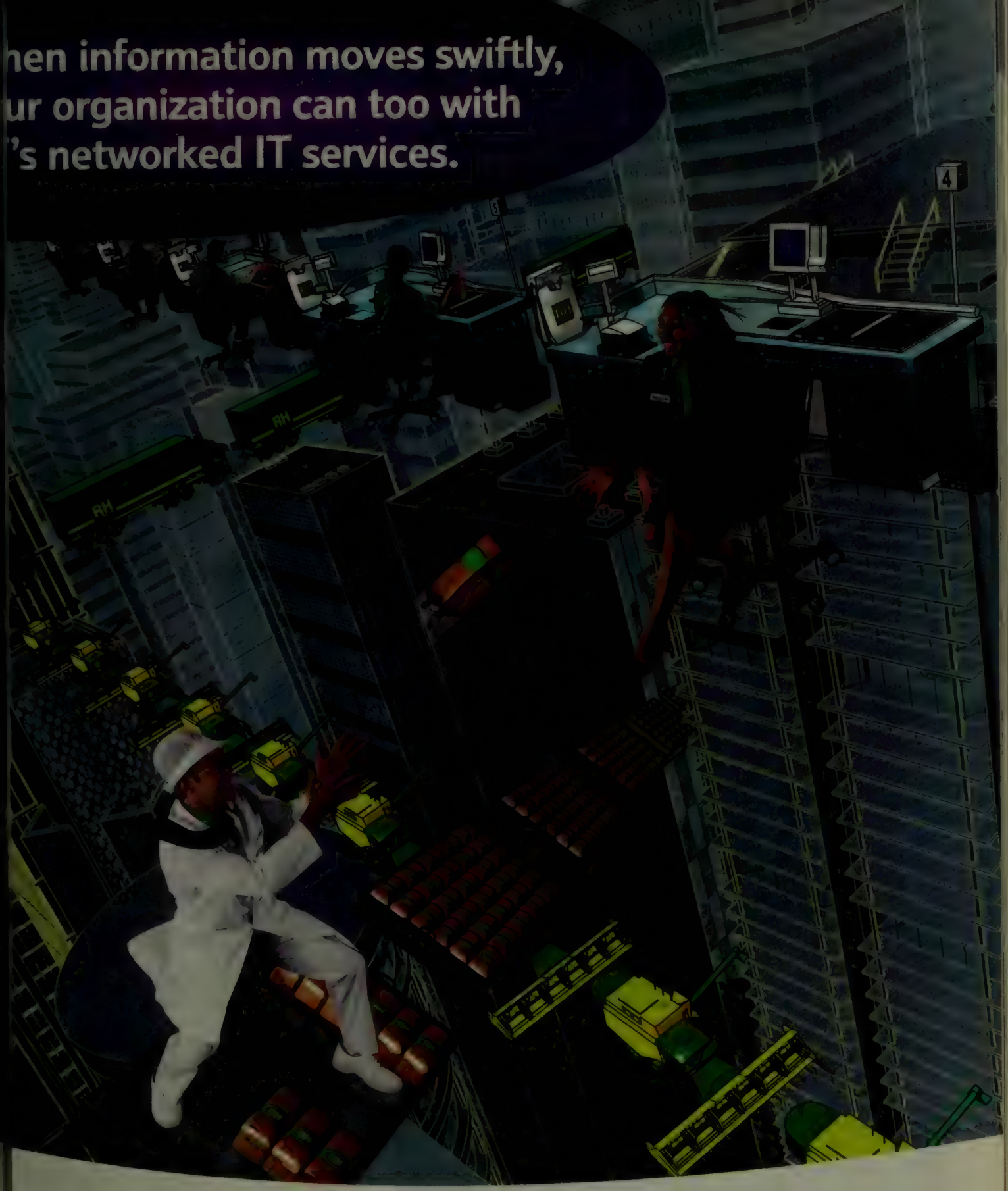
With PCs, aren't manufacturers likely to develop fixes in time?
They will undoubtedly send out patches to fix things, but a patch is only as good as its installer. If users ignore it or don't know how to upgrade their computers, they're not going to get upgraded. There are sophisticated systems that bring down time from a central location, but a lot of companies don't use them.

What can companies do to prepare?
Companies [should] examine their contracts. To limit potential liability, [they can] add specific protection clauses.

PRIVATIZATION

ROADS TO REVENUE States and cities have a new way to raise money: "For Sale" tags on the Interstate Highway system. On Sept. 28, Indiana Governor Mitch Daniels announced plans to put 157 miles of I-90 up for bids. Daniels also wants to invite private outfits to help build and operate a 142-mile extension of I-69 as a toll road. Meantime, governors of New Jersey and Delaware are urging lawmakers to privatize nearly 400 miles of combined tollways, including some stretches of I-95. The first experiment in a privately owned Interstate shows bright promise: At the start of the year, a Spanish-Australian joint venture paid $1.83 billion for the Chicago Skyway, a 7.8-mile stretch of I-90. The deal took a money-losing toll road off the city's hands, filled a budget deficit, and endowed a rainy-day fund. Seems everything has its price. *–Michael Arno*

DRAWN & QUARTERED



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FACE TIME

IN SEARCH OF BUZZ AT BELL LABS

Lucent Technologies Bell Labs' new president, Jeong Kim, wants to ensure the vaunted research institute lives up to its reputation for breakthrough technology. He says he's choosing "a selective few bets, so we can make a big impact." That includes using nanotechnology to create speakers and lenses not much thicker than a human hair. Placed on walls and clothes, they could pinpoint a person's location by picking up audio, video, smell, and movement cues. Kim predicts widespread adoption within 5 to 10 years.

Kim, 45, first joined Lucent Technologies in 1998 after the company acquired his communications equipment startup, Yurie Systems. Since his return in April from a teaching gig at the University of Maryland, he has been running the Labs as more of a startup, emphasizing risk-taking, speed, and creativity. Kim believes that his varied experiences will help him promote more new discoveries: "Everything about me is entrepreneurial," he says. *–Elizabeth Woyke*

LIQUID ASSETS

MILLER'S BIG CHANGING OF THE GUARD

IT'S QUITTING TIME at **Miller Brewing,** which means it's also hiring time. The brewer is facing an extreme version of the pending baby boom retirement wave. In the next three years, the Milwaukee beermaker says it has to replace a brewery's worth of salaried staff and three breweries' worth of hourly staff (out of its total of seven breweries). That's because in the 1970s booming demand—including for the new Miller Lite—led to a hiring surge as the company built a factory and staffed up elsewhere. Now those people are ready to call it a day. The average age of a Miller operations worker is 50.

With so many other companies moving their manufacturing work overseas, the brewer has plenty of well-trained workers to choose from. But Miller execs are scrambling to get them in the door before years of beer-making expertise walk out. So managers are hiring brewery workers, including machine operators, three months before they actually take a spot on the line, in order to serve an apprenticeship. And they're debriefing current staff and putting details on how they work into a database. Many top execs have already hit the exits: Since **SAB,** based in London, bought the brewe in 2002, Miller has replace among others, its CEO, an heads of finance and marketing. *–Nanette Byr*

MILLER LITE The Baby Boom cohort of brewery workers is starting to retire

CLASS NOTES

TEACHING KIDS ABOUT DOLLARS AND SENSE

WHEN IT COMES TO financial literacy, U.S. students typically score an F. Now a for-profit drama group is trying to remedy the problem. The **National Theatre for Children** (NTC) is performing 45-minute shows in New York for middle-school students, using sketch comedy to teach saving, budgeting, and credit.

The Mad About Money program started on Sept. 28 and, with **Citibank** as an initial sponsor, plans to reach 1,000 schools. The NTC has previously created shows on nutrition, energy conservation, and the environment.

Finance may prove a tougher sell, however. Lewis Mandell, a finance professor at the **State University of New York at Buffalo,** was hired by the NTC to evaluate the impact of its new presentation. Mandell oversees a biennial survey of financial literacy among high school seniors. In the 2004 survey, 65% failed a personal finance test. By targeting younger kids, Mandell hopes this show won't bomb. *–Mark Walsh*

THE STAT

95

Percentage of Americans who aren't getting enough Vitamin E in their diets. 40% aren't getting enough Vitamin A. 33% don't get enough Vitamin C.

Data: U.S. Agricultural Research Service's Food Surveys Research Group

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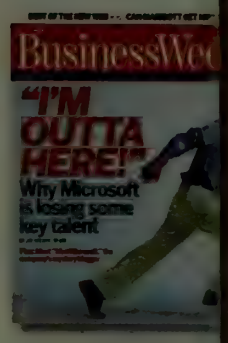
"Your account of Ballmer's vicious tirade against an employee who had jumped to a competitor was truly frightening to read."

–Mike Van Winkle
Ridgefield, Conn.



READING BETWEEN THE LINES AT MICROSOFT

HAVING WORKED at Digital Equipment Corp. for 20-plus years before its acquisition by Compaq and eventually by Hewlett-Packard, I find the parallels between Digital and Microsoft Corp. frightening ("Troubling exits at Microsoft," Cover Story, Sept. 26). Both companies were founded and run by singular individuals: Ken Olsen for Digital and William H. Gates III for Microsoft. Both companies relied on one or two products for much of their revenue: Digital on its VAX systems and Microsoft on Windows and Office. Both companies had extremely strong balance sheets. Digital for a while was one of the very few companies with an AAA bond rating.

At their zeniths, both companies had employee benefits that were the envy of the industry: Digital with family days at the local parks, turkeys for employees during the holiday, and exercise facilities at its main plants; and Microsoft as detailed in your article. Both companies began losing their top employees. When the competition got tough and the stock market demanded better results, both companies reduced employee benefits that had little impact on the bottom line but a lot of n ative impact on employee morale: bott water at Digital and towels at Microsof

Both companies viewed their stock undervalued and spent billions buy back shares. Both companies had ma reorganizations. I hope the parallels e here—Digital no longer exists.

–Gim P. H
Cambridge, M

WITH 25 YEARS of experience as a h man resources and organization cons ant, I found the hollow phrases Ballmer and his evasive response to pointed questions of your journali very recognizable. I've heard and s them before in numerous compan where, soon afterward, the chief execut and the organization were in deep trou and totally "surprised." The obsess need for good news and confirmation one's wishes completely cuts some top ecutives from the reality of their compa The gap between the described rea within Microsoft and the CEO's respo is such that a crisis is unavoidable.

If 15% of Microsoft's employees dissatisfied with the way things are r chances are that a large number of th

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I know that a quarter-inch right here is the difference between retro and "uh-oh."

But selling vintage dresses online- I'm just not sure where to start.

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Readers

CORRECTIONS & CLARIFICATION

"A vodka from the land of its birth" (Up Front, Sept. 26) should have noted that Stolichnaya brand vodka is distilled in Russia and bottled in Latvia.

"Taking the taint out of giving" (Social Is Sept. 26) should have stated that fulfillm of *Zakat*, which requires Muslims to give the poor, is based on net worth, not inco the accompanying table should have reflected net worth figures.

are among the top new talent of the pany. When (not if) they walk, the d ward spiral will be impossible to sto Steve Ballmer stop worrying abou short-term "needs" of his shareho and concentrate on the long-term su of the company they entrusted to hi

–Herman J. Ho
Antwerp, Be

READING this was like reading IBM 20 years ago.

–Cliff Cha
Hayling Island, Hampshire, En

STEVE BALLMER is not creative or s tive enough to nurture a culture of A ca's best and brightest techies. You count of Ballmer's vicious tirade agai employee who had jumped to a comp was truly frightening to read. It sh have been reason enough for Bill and Microsoft's board to fire him. Ta that action would, indeed, have met high expectations—those of Microsof ployees, stockholders, and suppliers.

–Mike Van W
Ridgefield,

A MILES-PER-GALLON INDICATOR COULD HELP FUEL EFFICIENCY

THE MILEAGE gains attributed to various design changes you repo were indeed impressive ("Getting miles to the gallon—fast," News: Ana & Commentary, Sept. 26). How you—and auto designers, apparen seem to have overlooked a simple an tentially effective design measure w could also bring savings of as muc 10% to 20%: Why don't all of our now have miles-per-gallon indicato prominent view of the driver? Thi stantaneous feedback of driving effi cy could quickly train drivers to op their vehicles in a fuel-sparing ma An alarm light or sound, activate wasteful acceleration, could provid havior-shaping feedback.

Most modern cars get maximum fuel ciency at speeds between 35 and 55 h, so an incentive to drive less than 55 uld save huge amounts of fuel nation- and would likely reduce the death e by 5,000 to 10,000 fatalities a year the 55-mph national limit did several ades ago). Such a device could poten- ly repay its costs within a few months.

–Karl Albrecht
San Diego

Y DEREGULATION AND ANSPORTATION DON'T MIX

MES ELLIS' explanation of the dys- ctional airline industry strengthened conviction that it's time for Congress reconsider its 1978 deregulation of vir- lly every aspect of the industry except ety ("The law of gravity doesn't apply," ws: Analysis & Commentary, Sept. 26). egulation of capacity would be a first p, and perhaps the only required step, ard bringing sanity to the industry. A nbination of entry regulation and te regulation could force capacity out he system and, long term, buoy prices. The airlines' knee-jerk opposition to form of economic reregulation, even ugh it would be a good tonic for them, contributed to the long industry slide he past 27 years.

–Tom Woodall
Rockville, Md.

RGET WIRED. HOW ABOUT OUNDPROOF HOTEL ROOM?

E MOST IMPORTANT feature of any el is rarely mentioned: peace and qui- "Marriott hip? Well, it's trying," Mar- ing, Sept. 26). I will pay a hefty premi- for soundproofing.

–Paula Berinstein
Thousand Oaks, Calif.

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Promise Keeper

RUNNERS Brinker with actress Jaclyn Smith

IN 1981, NANCY G. BRINKER made a promise to her sister, who was dying of breast cancer at age 36. The public relations consultant vowed that she would work to spare other women from suffering in the same way. It was a dramatic gesture, and it led to a dramatic result: A year later, Nancy formed the Susan G. Komen Breast Cancer Foundation, named after her sister. Having no fortune of her own, she needed a way to both raise money and draw attention to the cause. The novel solution, which she arrived at while jogging, was to start a series of five-kilometer charity runs named the Race for the Cure.

Such events are now ubiquitous (BW—Sept. 19), but the 1983 Race for the Cure was one of the first. And it has become one of the largest. Last year 1.5 million people in the U.S. and abroad participated in the Race for the Cure, raising $97 million in the process. Since its inception the Komen Foundation has collected more than $630 million for breast cancer research, education, screening, and treatment, and is considered a prime mover behind the progress in treatment since the 1980s.

At the time that Brinker founded the Komen Foundation, breast cancer was rarely discussed in public and was a low priority in oncology research, despite the fact that it strikes one in seven women. Brinker, 58, says: "I told my sister I would change this if it took me the rest of my life." She initially approached various charitable groups, but none was interested in focusing on breast cancer. So in 1982, Brinker gathered 20 women in her living room and asked for their help. "The oil business was booming in Texas back then," she says, and the group was able to raise $1 million in a year. But it was the Race for the Cure that made Komen a mega-foundation. The events also jump-started local chapters, which keep 25% of the money they collect for community education and screening.

Most important, the foundation has doled out more than $180 million in research grants. "There is hardly an advance in the science of breast cancer over the past 20 years that hasn't been touched by a Komen grant. That's what I'm most proud of," says Brinker, who survived her own bout with breast cancer in 1985. Scientists in the field acknowledge th Brinker's fund-raising, and the attention the Komen foundation has drawn to the disease, have played a large pa in improving the prognosis for patients. Brea cancer death rates have dropped 2.3% a year over the past decade, a greater improvement than any other of the five leading cancer kille When the tumor is caught early, women have almost a 100% chance of survival. "The advances we've made and continue to make are directly related to the involvement of the breast cancer advocacy community," says Dr. Larry Norton, chief of the breast cancer program at Memorial Sloan-Kettering Cancer Center. "Nancy is clearly a very early and important part of that effort."

> Race for the Cure has been key to funding advances in breast cancer research

In honor of her work, and for setting a template for other advocacy efforts, Brinker was awarded the prestigious Mary Woodard Lasker Award for Public Service in September. Brinker, said the Lasker Foundation, "dramatically increased public awareness about this devastating disease." Still, Brink says her promise to her sister is far from fulfilled. "We remain focused on one thing—a world without breast cancer," she says. "We will continue to address causation, as well as the disparities in treatment in medically underserved populations

So Brinker continues to Race for the Cure. In September she did those five kilometers in Budapest. ■

–By Catherine Arn

BusinessWeek online For updates on advances in breast cancer screening and treatment plus a Q&A with Monique Doyle Spencer, author of *The Courage Muscle: A Chicken's Guide to Living with Breast Cancer*, go to www.businessweek.com/extras

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BY STEPHEN H. WILDSTROM

Laptops: Now the Big Picture

If you have cruised the laptop aisle of an electronics store lately, you've probably noticed that nearly all the models on display sport wide screens like those on large-screen televisions. But if you work for a corporation or in government, you're not likely to see a wide-screen model around the office. Do consumers know something corporations don't?

They sure do. Over the past couple of years wide-screen displays ranging from 14 in. to 17 in. have come to account for the great majority of laptops sold in the retail market, which includes consumers and many small businesses. But when it comes to the enterprise, the three big makers of business laptops, Dell, Hewlett-Packard, and Lenovo, say that most information technology buyers won't even consider wide-screen designs.

The reasons are murky. Part of it seems to be the resistance to change that corporate IT managers show in all sorts of decisions. Part seems to be based on the assumption that the only thing wide screens are good for is playing DVDs—and corporate laptops are for work, not fun.

I was converted to the virtues of wide screens when I began using Apple PowerBooks. These were among the first popular models with screens whose width is 1.6 times their height, versus 1.25 times for a conventional display. For the past couple of weeks I have been using a ThinkPad Z60t—priced at $1,099 and up—a design that I think should be the future of computing for mobile executives. It's especially appealing with the optional built-in radio for Verizon Wireless's speedy, $40-a-month BroadbandAccess service. But because of the corporate disdain for wide screens, Lenovo is pitching the Z60t to small and midsize businesses.

THE Z60T FEATURES a 14-in. wide-screen display. Unlike the screens on most consumer-oriented notebooks, it has a helpful antiglare coating that's optimized for text and graphics rather than video. The computer weighs 4.6 lb., about 5 oz. less than the corporate workhorse T-series ThinkPad. Its 1-in. thickness is the same as the T's, but it's about an inch wider and an inch shallower front to back. The wide-screen design provides several advantages. For one, less depth translates into a lower profile when open. So when you're flying, the Z60t sits comfortably on a coach tray table, while the taller T (or a competitor such as a Dell Latitude D610 or an HP Compaq nc6200) barely fits. The screen offers more than 90% of the viewing area of the 14.1-in. standard display of a T-series. And the Z60t screen is a lot bigger than that of an airplane-friendly ultralight with a 12.1-in. standard display. As a bonus, the extra width allows for a no-compromises full-size keyboard.

LATERAL EXTENSION Adding a sideline lets you see more

Wide screens aren't just for movies. They also open out windows and spreadsheets

Working with the wide-screen display has convinced me that it's not just for movies. Compared with a standard screen, less of a typical page is visible without vertical scrolling. But the width makes it much easier to work with two windows side by side. I find it convenient, for example, to keep my e-mail open in one window with a word processor document or a Web page open next to it. A wide screen also offers room for one of the increasingly popular sidebar programs, such as Google Desktop. You quickly see the efficiency of a horizontal layout. And, of course, it's a big advantage for wide spreadsheets.

I expect that the corporate antipathy toward wide screens will eventually break down. As panel makers crank them out in greater volume, prices will come down—and price is something corporate IT departments understand.

By the middle of next year I think the workhorse corporate notebook will come with a 14-in. or 15-in. wide-screen display. And there will be 12.1-in. wide screens for laptops weighing less than three pounds. You may find the changes a little odd at first, but once you get used to wide screens, there's no going back.

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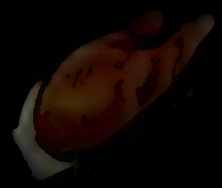

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BY JON FINE

Media, Marketing, and Advertising in the 21st Century

Old Media's Lame-Duck Days

Remember merger mania? Remember the bigger getting bigger yet? Remember when the prices of media stocks weren't stalled? ¶ Me neither. ¶ DreamWorks and NBC Universal go deep into talks. Microsoft and Time Warner play footsie over a possible MSN/AOL link-up. In both cases, news of the talks leaks. The gasbags start gasbagging. The headlines get teed up. And...nothing happens.

Welcome to the new modesty. The moment of non-mergers. This is appropriate because the media landscape is slowly repopulating with non-moguls. (Was that Michael D. Eisner walking the halls at an investor conference last month before watching his successor Robert A. Iger from the audience? Yes.)

The modesty is appropriate because something existential is happening. The traditional players face big questions: How far do old-media skills get you with new-media consumers? Put another way: Does business sense translate across generations? These have implications for everyone from News Corp.'s Rupert Murdoch to Yahoo! Inc.'s Terry S. Semel, the old-media guy riding the new-media rocket.

LATE 2005 MAY BE REMEMBERED as the interregnum between the era dominated by the old media giants and the one in which Yahoo! and its ilk began running things. (This is the Big Media analogue to the Ford and Carter Administrations.) But it's hard to advance when events keep one rooted in the past, and to a remarkable degree many big old-media guys still live with the aftertaste of deals from a faraway, much happier time.

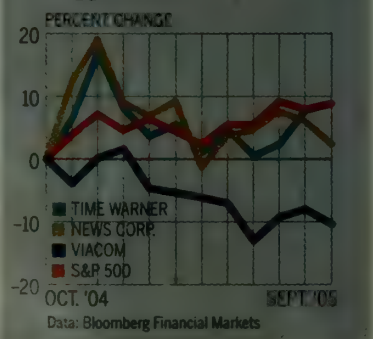
This is not just about Time Warner's love-hate-love mood swings with AOL or Viacom Inc. splitting itself in two. Tribune Co.—one of the least mogul-y big media conglomerates—now has a tax liability of $1 billion, give or take, from its 2000 acquisition of Times Mirror. That deal, for $8 billion, magically magnified Tribune's presence among major-market newspapers by netting it the *Los Angeles Times* and *Newsday*. It turns out, in 2005, those are exactly the kind of newspapers you don't want to own because new-media competitive pressures are most intense in big cities. (That deal also brought Tribune the Spanish-language daily *Hoy*, which, along with *Newsday*, got the company in serious trouble last year by misrepresenting its circulation to advertisers.) Tribune's stock price just before the Times Mirror deal: $34.92. Today's price at the close of the third quarter: $33.61.

O.K.

So if some big old-media deals look bad, are big new-media deals good? Especially if, let's say, they're for assets teeming with traffic from the young consumers who allegedly shun old media? Well, ask News Corp. and New York Times Co. how well their stocks didn't do after they bought myspace.com parent Intermix Media Inc. and about.com. News Corp. has spent $1.3 billion on young-skewing online buys within two months, and Murdoch has been relentless in discussing the need to grab younger consumers. But so far the Street is skeptical (chart).

STUCK

Big media stocks are bogged down



Data: Bloomberg Financial Markets

If acquiring bits and pieces isn't budging the stock price, what will? It's extremely difficult for an old-media player to build a serious new-media asset. There are established competitors. There are generational issues. (Myspace would not have become myspace had it been launched by News Corp.) And there are the quarterly numbers that Wall Street demands when it's not whacking the moguls for being too dependent on mature businesses.

To move the needle right now, you need something massive. You need, for instance, to buy Yahoo. Of course, today it's too late to buy Yahoo. Today, Yahoo buys you. Assuming, that is, that Yahoo thinks its business sense can cross the generational divide. Or that it's even worth the bother. ■

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The Barker Portfolio

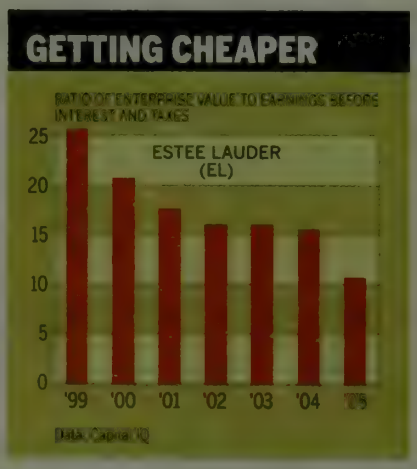
BY ROBERT BARKER

A Beauty in the Bargain Bin

What's the critical difference between a Micro-D Deep Thermal Refinisher and a Resilience Lift Extra-Firming Revitalizing Mask? Don't ask me. But you don't have to be a discerning consumer of Estée Lauder's multitudinous potions to spot an opportunity in the cosmetics maker's shares, which since January have worked their way down some 26%.

The latest blow fell late in September, after the New York company warned investors of weaker earnings in the first quarter of fiscal 2006. The stock sank below 34, a depth not seen in two years. Just the same, a glance at Estée Lauder finds it's hardly about to go the way of its eponymous founder, who died last year. A closer look finds a company of substance that has tumbled into the bargain bin.

YES, LAUDER IS SHOWING some wrinkles and warts, not least the ongoing consolidation of its primary outlets, department stores. Lauder's two biggest customers, May Department Stores and Federated Department Stores, completed their merger in August. That's one reason behind the slowdown in sales. Nor did it cheer investors to learn that Ronald Lauder, one of the founder's sons and a director, sold some stock just days before the company's profit warning. A spokeswoman notes that Lauder's sale amounted to a small part of his stake and that "he continues to be a committed shareholder." Insider sales—at Lauder or any other company—are never bullish. More meaningful to me, however, is what Chief Executive William Lauder (Estée Lauder's grandson) did in September when he exercised options on 50,000 shares, which were due to expire in November. He did not then turn around and sell the shares, as often happens with exercises of employee options, but is holding them.



In any case, the company's financial statements hardly offer a rationale for dumping Lauder. The company has amassed a strong balance sheet. At last report, cash came to $553 million and total debt to $715 million. Its debt-to-capital ratio, a bit below 30%, is less than at rival Avon Products (50%), never mind Revlon (a financial fright with a negative net worth). Even after capital spending of $230 million and paying $90 million in dividends, Lauder still had produced more than $159 million of free cash flow during fiscal 2005, ended last June.

ESTEE LAUDER AD Paltrow stars in a new campaign to lure younger buyers

What's more, Lauder isn't shrinking—it's just growing more unevenly than it had expected. This fiscal year the company still sees sales rising perhaps 6%, not counting foreign-exchange effects, but with a speedier second half making up for a slowing in the summer quarter. Notably, Lauder is now deducting from its reported earnings the cost of granting stock options as employee pay, an expense it figures will come to 14¢ or so per share this year. Even after that charge, Lauder expects that its widening profit margins will produce earnings per share this year of at least $1.95. If reached, that would be a gain of nearly 17%.

To feed growth, Lauder is counting on more gains abroad, not just in Europe but also in such Asian markets as Hong Kong, Taiwan, and China. Back home, it has been developing lower-priced brands, such as American Beauty, Good Skin, Grassroots, and Flirt!, which it's pushing through Kohl's, a growing chain. All told, including its core Estée Lauder and Clinique lines, Lauder now has a total of 26 brands, including many it is selling via the Web or in their own stores. One such brand is Origins, a line of natural-ingredient lotions and cosmetics with 131 freestanding outlets. Finally, the company is hoping to attract younger women to the flagship Estée Lauder line with the face of actress Gwyneth Paltrow, soon to appear in holiday ads for the fragrance Pleasures.

Any of these initiatives may falter, but such risks today strike me as well reflected in Lauder's price. Near 35, the stock goes for a multiple of enterprise value to operating earnings of under 11 (chart). The stock also yields 1.1%. Think of the payout as a gift with your purchase. ■

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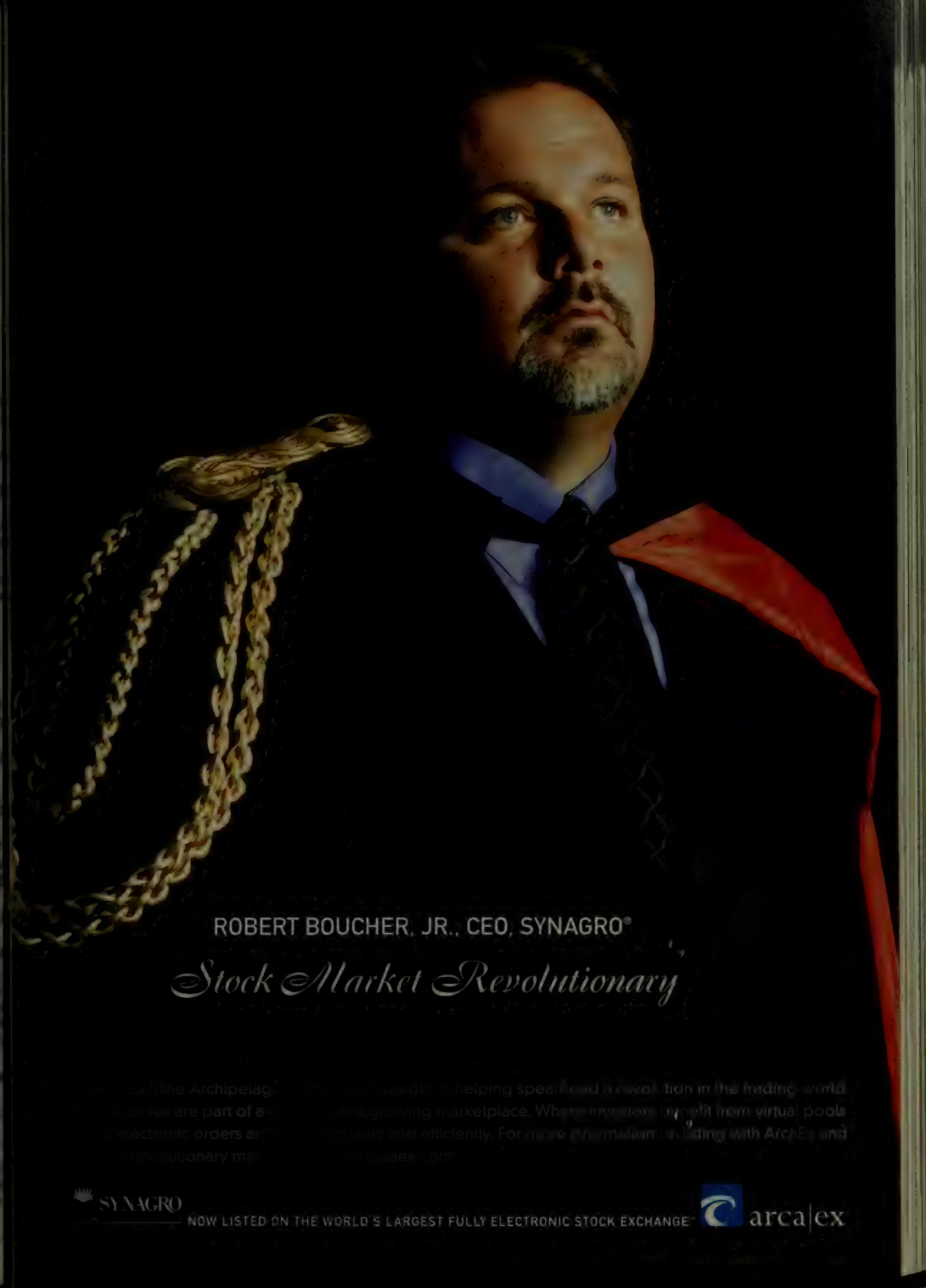
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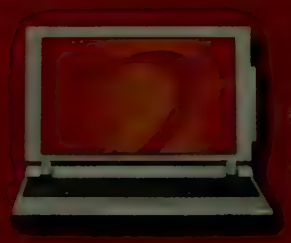

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- CD-RW/DVD-ROM combo drive
- 10.6" WXGA active-matrix display

VAIO

$1849 NOTEBOOK CDW 790094
-200 TRADE-IN
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  - Intel® Pentium® M Processor 740 (1.73GHz)
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JAMES C. COOPER & KATHLEEN MADIGAN

Rate Pressure Starts Leaving a Footprint

turn in bond-market sentiment will help to tamp down the housing boom

U.S. ECONOMY Has the bond market blinked? After more than a ar of resistance to rate hikes by the Federal Reserve and continued onomic strength, bonds finally seem to be giving some ground. And hlike other short-lived sell-offs that pushed bond yields higher, this cent pickup in long rates appears to reflect a more lasting shift in d market sentiment. If so, then the Fed's efforts to p the economy from overheating will take hold. And portantly, housing will continue to cool off.

Vhat's different now? One, the Fed has made it clear it stands ready to lift short-term rates more than the d market had expected. Two, new reports suggest that industrial sector is not rolling over in the wake of rina and higher energy prices. Three, inflation outside nergy may not be as tame as previously thought. And lly, post-hurricane relief efforts from Washington mise to swell federal financing needs, putting itional upward pressure on yields.

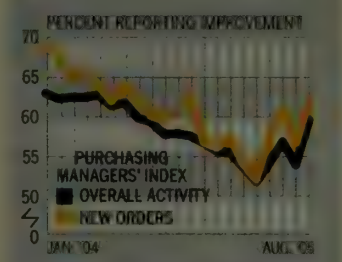
ll this means that prospects for an end to Fed tening and the continued quiescence of inflation are as certain as bond investors once thought. Except for porary breakouts in 2003 and 2004, the yield on a 10- Treasury note has been in a tight range of 3.5% to % for over three years. Already the yield on a 10-year sury bond has risen from 4% in late August to nearly % in early October before backing down a bit by Oct. 5. o be sure, a weak output or inflation number will ys cause at least a brief rally in the bond market. But d actions and economic data continue to reinforce idea that inflation is a threat, long rates, including tgage rates, will keeping rising well into 2006.

TER ALL, inflation expectations are, for the most part, t determine bond prices and yields. And the latest ds from the Fed sound unexpectedly hawkish about tion prospects, with increased concern over the sible pass-through of higher energy costs into prices erally. For example, on Oct. 4, Federal Reserve Bank allas President Richard W. Fisher, a voting member e Fed's policy committee, said: "Now, the inflation is near the upper end of the Fed's tolerance zone, and ows little inclination to go in the other direction."

his new tone highlights a change in Fed thinking ut the possible impact of higher oil prices on the nomy, a view now being echoed in the bond market. iously the mindset was that costlier oil hurt nomic growth more than it lifted inflation outside of gy. Spiking oil and gasoline prices tended, therefore, olster bond prices and keep yields low.

But the economy has only bent, not cracked, under $3 per gallon gasoline. The Institute for Supply Management's index on activity in the nonmanufacturing sector fell sharply in September from August, but it still indicated continued growth. And the ISM's index of manufacturing activity was a real head-turner (chart). That index showed that the industrial sector's momentum accelerated last month. It scored its largest monthly gain since 1991, reaching the highest level in more than a year. Readings on orders, production, and employment all strengthened from August. The advance suggests industries outside the storm-affected areas are on the upswing and that they are starting to benefit from relief and rebuilding activity.

INDUSTRY ACTIVITY KEEPS ITS MOMENTUM



Data: Institute for Supply Management

The ISM results are in line with a survey by the Business Roundtable, which shows that corporate leaders aren't overly concerned about the hurricanes' impact on their companies. Clearly, the business sector, with a big assist from government spending, looks ready to make up for whatever consumer demand the economy may lose.

BUSINESSES MAY FEEL MORE SANGUINE about the future because higher energy costs, along with an economy growing near its full capacity, give them more cover to mark up prices. Indeed, a worrisome part of both ISM reports for bondholders was the fact that the prices of an increasing number of goods and services are rising.

Pricing power will be heightened by the additional supply constraints caused by the hurricanes. The ISM reported a large increase in companies reporting slower delivery times for goods ranging from textiles to furniture to metals to various types of industrial equipment. Those delays suggest production and distribution bottlenecks that make it easier to pass along price increases.

One important test of companies' ability to cope with

costlier energy will be the performance of third-quarter profits, on which reporting will begin soon. If earnings outside of energy companies hold up well, then greater pricing power is undoubtedly helping to shore up the bottom line. But evidence of more pricing power will only add to the bond market's uneasiness.

IF SO, THEN WATCH for higher rates to bring about an end to this decade's housing boom. Indeed, it's looking as if housing peaked this summer. Of course, anecdotes aren't enough to indicate a slowdown, since sales typically fall off after the summer because families want to move before the school year begins. But the seasonally adjusted data also show housing's roar is quieting down.

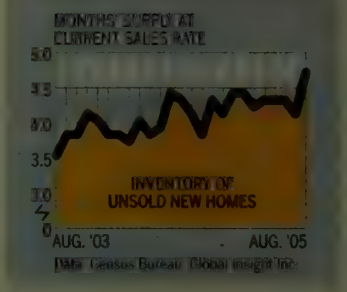
For one thing, more homes are available for sale. Builders are holding a 4.7 months' supply of unsold new homes, the highest rate in more than five years (chart). And the inventory of unsold existing homes, as seasonally adjusted by Business Outlook, shows that months' supply has been trending higher since April.

Moreover, the National Association of Home Builders/Wells Fargo housing market index fell to 65 in September, the lowest level in more than two years. The NAHB said the report did not include responses from Katrina-hit areas, which make up just 2% of the survey. But builders elsewhere are increasingly concerned about mortgage rates, buyer resistance to high home prices, fuel costs, and lot shortages.

A cooler national housing market would come at a good time, since much of housing industry's resources will shift to the Katrina rebuilding effort in 2006. That means measures of housing starts and residential investment, which go into the calculations of real gross domestic product, won't slip by much next year.

But outside the hurricane area, higher mortgage rates will dampen home sales and price increases. Remember that affordability is a function of monthly payments. At 5.5%, home buyers face a $557.75 monthly payment for every $100,000 borrowed on a 30-year fixed mortgage. At 6.5%, the payment jumps to $618.83. Given the squeeze on budgets from higher energy bills (page 36), buyers will have less leeway to bid up prices. And with the rising inventory of homes out there, some local markets may be shifting to favor buyers over sellers.

ONE SIGN THAT HOUSING IS COOLING OFF



Credit is the lubricant that keeps the economy moving smoothly. But with price pressures growing at a time when the federal government may be borrowing at a record pace, investors are likely to want a fatter return on their money, slowing the demand for big-ticket items such as cars and homes. Higher rates won't cause a big slump next year, but expect them to pour some sand into the economy's gears. ■

FRANCE

Consumers Lose Their *Joie de Vivre*

WITH ENERGY PRICES soaring, the outlook for French consumers will depend greatly on the labor markets.

Consumer spending was healthy over the summer, with price-adjusted demand for manufactured goods up 1.2% in July and 1.9% in August. But retailers had to use discounting to draw in shoppers, and incentives helped to lift vehicle sales in September as well.

Consumers are more price-conscious because rising fuel bills are eating into their budgets. Higher energy costs pushed total yearly inflation from 1.7% in July to 1.9% in August, and given the September oil spike, inflation probably rose further last month.

Consumer confidence inched up in September thanks to better-looking job markets. The jobless rate held at 9.9% in August, staying below 10% for the second month in a row. But public subsidies to hire entry-level workers helped cut the number of jobless workers younger than 25 by 1.2%. The number of unemployed workers aged 25 to 49 rose.

BUSINESS SENTIMENT IS STILL SLUGGISH

Future progress on the job front will depend on the private sector, and here the news is mixed. Business confidence remains sluggish, although hiring plans have picked up a bit. And purchasing managers were slightly more upbeat in September, but their view on jobs fell to the lowest reading in two years.

What may hold back hiring in coming months is that businesses have so little pricing power. The September purchasers' survey showed energy costs helped push up input prices, but the index for output prices declined. The imbalance is squeezing profit growth.

Private economists expect that French real gross domestic product will struggle to meet the government's growth forecast of 1.5% to 2% this year. Prime Minister Dominique de Villepin has proposed tax cuts and spending increases to lift growth over the next two years.

Such budget changes guarantee that France will—once again—miss the European Union's target of keeping a fiscal deficit to less than 3% of GDP. But the government may be willing to bust the budget. After all, presidential elections are set for 2007 and France has not met the deficit requirement since 2001. ■

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THE ECONOMY

LIVING TOO LARGE IN EXURBIA

Big houses. Big cars. Now, bigger bills. A lifestyle built on cheap energy and cheap credit is jeopardy

BY MARK MORRISON

FOR THOSE WHO MADE THE exodus to the rolling farmland of Loudoun County, Va., over the past decade, the trade-offs were well understood. Stake a claim to the exurban dream in newly sprouted developments with bucolic names like Farmington on the Green and Hirst Farms (going price: $600,000 and up), and you got a brand new house on a quarter acre. Excellent schools, the small-town charm of antique shops, and historic courthouses were also part of the package. And just watch your home value soar, by an average 23% in the past two years.

The downside? Everyone wanted to join you. Population in Loudoun grew 41% between 2000 and 2004, faster than any other county in America. Road construction couldn't keep up, so traffic is often a nightmare. Even on the weekend, the drive into Washington takes an hour and a half. At rush hour, figure on two. Caterpillar tractors and orange highway construction cones have taken the place of the horses and cattle that used to dot the hillsides. Still, it all seemed worth it to those like Andrea O'Hara, who moved from Pittsburgh with her husband and three children a year and a half ago. "We love it here," says O'Hara.

DIVERSE INCOMES

THESE DAYS, THOUGH, a chill is sweeping through the fast-growing exurbs that have popped up like mushrooms on the outskirts of established cities and suburbs all across America. A lifestyle built on cheap energy costs and low mortgage rates is in jeopardy. Consumers who hardly gave a thought to gassing up when regular was $1.50 a gallon are abando ing their hulking sport-utility vehicl and pickups, signing up for carpools, a leaving the motorboat in the backya now that prices are stuck at nearly twi that. And with heating bills expected jump as much as 70% for many this wi ter, more pain is on the way.

Experience says that most America will turn down their home thermost and break out the fleece. But if super-hi energy prices persist for the next f years, as now appears increasingly like they will put a world of hurt on the tho sands who already were stretching th budgets to live in the outer suburbs a rural fringes. As exurbia struggles wi this new hurdle, what has grown int huge new social and economic force w face its first real challenge.

Love them or hate them, the exurbs

ALSO IN THIS SECTION:

40 All of a sudden, small cars are cool

42 Behind the Sun-Google alliance

44 Why business likes Bush's court picks

ricier **Dreams**

Exurban Dream is all about freedom—a spacious house, verful SUV and roomy minivan in the two-car garage, and lawn ar as the eye can see. But rising prices of gasoline and heating , viewed here through a hypothetical Chicago exurb, forcing some to reconsider their lifestyle.*

EELING A DRAFT

ST OF HEATING A 00-SQUARE-FOOT HOUSE

INTER '03–'04

$1,053

INTER '05–'06

$1,966

SHOP-AND-GO TRAFFIC

GAS BILL FOR DRIVING AROUND TOWN

OCTOBER '03

$70

OCTOBER '05

$123

A GROWING EXPENSE

MONTHLY COST OF MOWING THE LAWN

OCTOBER '03

$20

OCTOBER '05

$35

BATTEN DOWN THE HATCH

MONTHLY COST FOR THE BOAT

AUGUST '03

$224

AUGUST '05

$396

RIDING HIGH (AND DRY)

GAS BILL WITH A 100-MILE DAILY COMMUTE

OCTOBER '03

$231

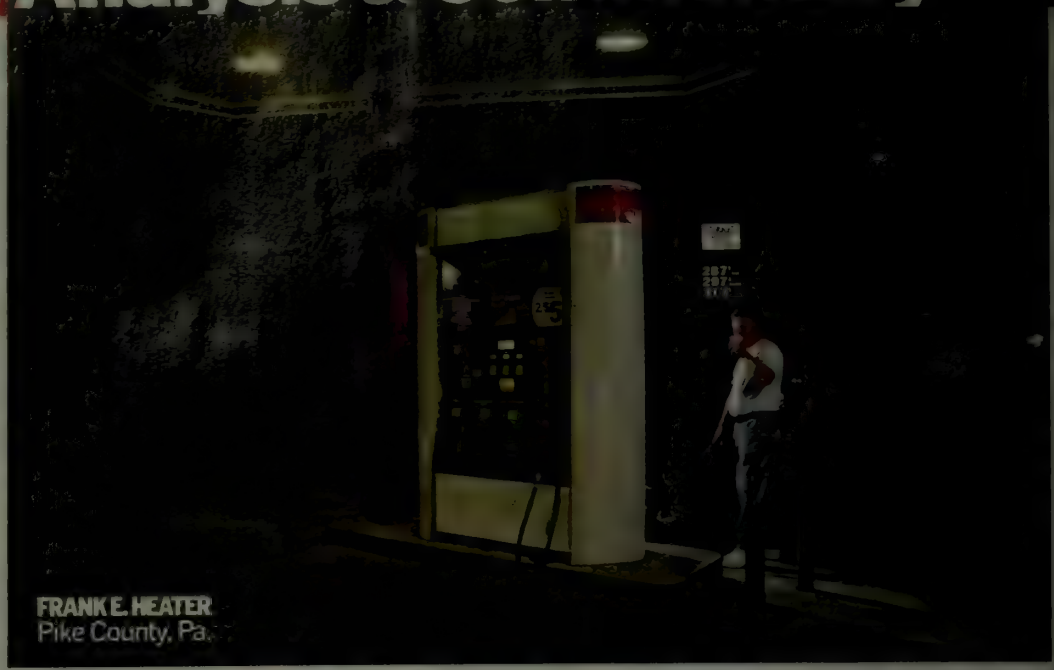
OCTOBER '05

$407

* [illegible] American 4WD with 16 mpg used to commute 100 miles a day during the [illegible] weekends, a 2004 Pontiac Montana FWD with 22 mpg driven 30 miles a day, a 20-foot Chris-Craft Speedster [illegible] and refilled once per outing, a John Deere L100 riding mower used 4 days a month [illegible]

Data: Energy Information Administration, U.S. Energy Dept., Chris-Craft Corp., Business Week

playing an increasingly important role in America's cultural landscape. In the minds of critics, the exurbs tend to attract conservative young families whose communities and lives often revolve around megachurches. Liberals blame the exurbs for reelecting President Bush in 2004. Conservationists blame them for spoiling the landscape with ugly sprawls of look-alike houses and promoting wasteful lifestyles.



FRANK E. HEATER
Pike County, Pa.

"The gasoline is killing me"

Supporters of exurbs see a much different picture. Author David Brooks, whose book *On Paradise Drive: How We Live Now (And Always Have) in the Future Tense* examines the exurban phenomenon, often points out that exurbs are highly diverse and getting more so. They provide a high quality of life for many, including millions of immigrants. Indeed, exurbia has attracted both upper-income families who live expansive lifestyles and middle- and lower-income families who move to the far fringes of metro areas because it allows them to step up the ladder to a bigger house, better schools, and a nicer life than they could afford closer in.

BRETT LUCCKETTA
With his wife, Kristy
Enterprise, Nev.

ECONOMIC ENGINE

WHILE MANY OF America's biggest cities continue to lose population, and inner suburbs are suffering symptoms of old age, out in the exurbs it's a different world. Between 2000 and 2004 exurbia accounted for 17 of the 20 fastest-growing counties in the nation with more than 10,000 people. The population has mushroomed in once-rural counties near Atlanta, Dallas, Reno, and other cities. And that's certainly reflected in commute times: According to the Joint Center for Housing Studies at Harvard University, the number of workers in the 49 largest metro areas commuting an hour or more increased by 2 million between 1990 and 2000; in the rest of the nation there were 1 million more hour-away commuters.

But with energy costs soaring and a hike in interest rates likely in the months ahead, all of a sudden the Exurban American Dream is looking a whole lot tougher for many. Just ask Frank E. Heater, a carpenter who lives in Pike County, Pa., a fast-growing exurb of New York City. To afford his 3,500-square-foot ranch home, planted on five wooded acres, Heater pulls out of his driveway at 4:15 each morning to drive his Ford Expedition 86 miles to New York. In the best of times, his routine was grueling: "Come home, eat, shower, sleep, and you're back on the road again." But his gasoline bill now hovers around $180 a week, about double what he paid two years ago and an ever-growing big bite out of Heater's take-home pay. Now he wishes he could take the bus, tools at all. "The gasoline is killing me," he say

"I am living the American dream, but it hurts some months"

The economic consequences of slowdown in exurban exuberance is d ficult to measure. Clearly the exurbs' ra id growth has been one of the main e gines of U.S. economic expansion recent years. Consider all the hom building plus the malls, box stor restaurant chains, fire departments, a

O'HARA
County, Va.

> "We just sat down ...and tried to figure out how to cut back"

ools that have popped up on cheap nland beyond the suburbs. The new vals provided huge growth for retail- and other service companies, hun- ds of thousands of new jobs for chers, firemen, and the like, and en- reneurial opportunities galore. In- d, it is unlikely that the U.S. economy ld have outperformed every other or industrial country in recent years hout the explosion of exurbs and r ripple effects on business.

ven if the exurbanization of America t likely to end anytime soon, the ying double-digit growth that has n taken for granted in many markets ld be slowing. Some homebuilders e already started to hedge their bets urning to close-in locations. Houston eloper Sam Yager III is still aggressively expanding in exurbs like Rosenberg, 37 miles southwest of Houston. But after years of developing primarily on the outskirts, he is now also creating City Park, a project near Houston's medical center, featuring $90,000 to $140,000 homes. Sales are strong, even though the lots and homes are much smaller than those for comparable money in the exurbs, and they are in the Houston Independent School District, which some young families want to avoid.

Higher energy bills and mortgage rates are not as likely to affect the more affluent. In Beacon Hill, a new development in exurban Purcellville, Va., carved from the former estate of the late Arthur Godfrey, homes are gigantic—up to 14,000 square feet, with libraries, wine cellars, and see-through fireplaces—and sell for up to $3 million. Says Mitchell S. Freedman, an insurance broker who moved to Purcellville in July: "Those of us who live here are in economic circumstances where we don't worry about $3-a-gallon gas or the price of propane."

But plenty of other exurbanites do have to worry. In Loudoun, the cost of feeding a van and a Subaru Outback SUV already has Andrea O'Hara consolidating her errands into one trip. Heating the family's four-bedroom, three-bath house with propane figures to be 50% more costly this year. "We just sat down and looked over our budget and tried to figure out how to cut back," says O'Hara. One idea: consolidate several local carpools into one van to help beat the daily $6 tolls and pricey gasoline. A neighbor says families are buying wood-pellet burning stoves to supplement their heating this winter. And the rising costs are already having an impact on the real estate market. "Houses here, once gas hit $3, started to stay on the market longer," says Robin Frank, owner of nearby Brown-Carrera Realty. "A house that would have had multiple bids suddenly just got one bid in three weeks. People are being cautious now."

Some are also starting to have second thoughts about the size of those expansive new houses they've bought. Since 1992 the average new house has expanded 12% and the number with four or more bedrooms has climbed dramatically to 37%. Now the bill is coming due. Brett Luccketta, 32, moved from high-cost Orange County in Southern California to Enterprise, a fast-growing Las Vegas development last March. Even with some $10,000 of energy-saving adds-ons to his new four-bedroom, $285,000 home, Luccketta was shocked when his electric bill topped $300 one month. Now he and his wife Kristy use ceiling fans and keep the thermostat at 77F to save money. Still the Luccketts, who plan to have children soon, are thinking about trading down from their 2,200-sq.-ft. home to a 1,600-sq.-ft. townhouse. "Babies don't need giant bedrooms," he says. "I am living the American dream, but it hurts some months."

HERE TO STAY

IT MAY TAKE MANY MONTHS of hurt before big numbers of city dwellers seriously start to consider reversing their exodus to exurbs. As transportation consultant Alan E. Pisarski notes, a two-decade stretch of extremely low-cost transportation has conditioned commuters to accept longer drives. For the time being, even extreme commuters who spend a total of four hours each day going back and forth to work will probably try to avoid moving closer to town. Joel Kotkin, an urban planner and author of *The New Geography: How the Digital Revolution Is Reshaping the American Landscape*, says that many exurbs are fast moving beyond the inefficient model of bedroom towns. Instead, they're fulfilling the original purpose of a more traditional city, with high-quality jobs and cultural amenities. That's why he believes the exurbs are here to stay, no matter how high energy prices go. Exurbanites may "get smaller cars," he says. "But they are not going to pack up and move to the city."

As the exurbs take root and evolve

into communities in their own right, more new jobs are likely to find their way to these outer areas. In many U.S. labor markets where skilled workers are in short supply, exurbanites will likely get relief as more companies move operations closer to the outlying areas where workers live or encourage more telecommuting. But until enough of those jobs show up, Pisarski predicts, "shifting to smaller homes that are closer to jobs could become the trade-off that many workers prefer."

Even if current residents hold tight to their exurban life, a big question in the near term is whether new families will keep flooding to the outskirts. Any hesitation by buyers could leave developers and homebuilders in a bind.

Unsold homes are at their highest in five years

The availability and price of mortgages will also weigh heavily, and some economists believe that the Federal Reserve, with its frequent rate increases, is determined to apply the brakes to the runaway housing market. Long-term interest rates have jumped by nearly a half percentage point over the past month on growing fears of faster inflation and tough talk from Fed officials about the need to contain it. The higher borrowing costs are starting to put a damper on the overheated housing market. Builders now hold a 4.7 months' supply of unsold homes, the highest level in more than five years. If housing cools off, the exurbs could be among the first places to feel the pain.

The moment of truth for many exurbanites may be coming soon, says Vern S. Lazaroff, an attorney in Milford, Pa., and Port Jervis, N.Y., who specializes in personal bankruptcy. "A lot of people here get mortgaged up to their necks," he says. Once winter comes, "there's no way to pay for the fuel oil and the mortgage in the same month. There's just no way. I expect to see a huge number coming to my office."

If Lazaroff is right, it could mean a nasty winter for folks living way out in the 'burbs. The American Dream of a better life away from the city is hardly over. But it could be in for a few tough knocks. ■

–With Paul Magnusson in Loudoun County, Va., Peter Coy in Pike County, Pa., Christopher Palmeri in Los Angeles, and bureau reports

CARMAKERS

SUDDENLY, SMALL IS BEAUTIFUL

Buyers are flocking to little cars—and not just because of high fuel prices

IT HAS COME TO THIS: EVEN Texans are having second thoughts about their big trucks. In Fort Worth, deep in the heart of truck country, the Mortiz Kia used-car lot is packed with big sport-utes and minivans that buyers have traded in for cars that look pint-size by comparison, including the Sportage small SUV and Spectra compact. During the big-SUV boom, many buyers stretched their monthly budgets to lasso one of the monsters. But as gas prices jumped 50%, sending the cost of filling up the tank of a large SUV north of $70, those gigantic gas-eaters stopped looking so alluring. Customers, says Kia new-car sales manager David Benker, "want something smaller to drive to work every day."

America is still a far cry from Europe, where the family car is often a compact. In the U.S., downsizing often means trading a huge SUV for a slightly smaller one. Still, for those willing to truly trade down, the good news is that a fresh crop of little cars is making small cool again. While soaring prices at the pump are probably the single most important factor drawing buyers back, small cars are also benefiting from smart designs a youthful, edgy marketing. The bol styled Mazda 3 is one of the hottest c on the market, with sales up 45% t year. High-end small autos such as Mini Cooper convertible and the all-n Audi A3—as well as dirt-cheap Kore made Chevys, Kias, and Hyundai pushed sales of small cars up 23% September. They now make up 18% the U.S. market, a major leap from 13.6% they claimed a year earlier, cording to Edmunds.com Inc., a Sa Monica, Ca.-based auto research firm

At the same time, car buyers are ab doning SUVs in droves. With sales 33% in September, sport-utes grabb just 14.5% of the U.S. market, down fr 19.4% a year ago. Is this the big s away from SUVs that has long been p dicted? Tom Libby, an analyst with J Power & Associates Inc.'s Power Inf mation Network, says defections fr larger vehicles to compacts picked last month. Yet experts like Libby belie gas prices will have to stay at today's l els or even rise higher to force a who sale change in what Americans buy.

However significant the change, o thing is clear: Auto makers are mov

BMW 1 SERIES

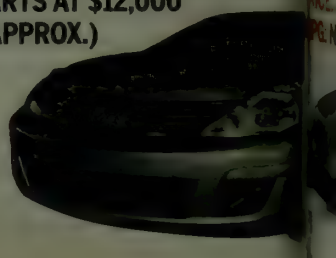
More *joie de vivre* for compact buyers: BMW's sporty 1 Series will hit U.S. roads in 2008

PRICE: NA
MPG: 29

NISSAN VERSA SEDAN

Next June, Nissan will bring out the Versa as a smaller, more efficient alternative to its Sentra compact

PRICE: STARTS AT $12,000
MPG: 35 (APPROX.)



MINI CONCEPT CAR
A stretch version of the popular motor mite will arrive in 2007 featuring more room and the same retro styling
PRICE: NA
MILEAGE: NA

iftly to put
ıewed focus on
ir small-car offerings.
ne are the days of churning out
ɔnoboxes. Now the push is on to add
ashy styling and make downsized cars
ɔmier and more fun to drive. Carmak-
are betting that, by offering up sporty
npacts, small wagons, and crossovers,
y can get better prices and, ultimately,
her margins.

ING IT RIGHT

S NOT SURPRISING, then, that fleets of
ninutive new vehicles will be rolling
o dealers' lots before too long. Chrysler
oup will replace its old Neon compact
h a trio of small, spiffy Jeep and Dodge
ries starting next year. BMW plans to
ng its new sporty compact 1 Series to
U.S. and launch a roomier Mini in
07. Ford is toying with some new com-
cts, and Nissan Motor Co. will launch
subcompact Versa next June. Says Jo-
n de Nysschen, executive vice-presi-
nt of Audi of America Inc.: "Companies
trying to build good cars that just hap-
n to be small."

It has taken awhile, but other carmak-
are finally catching on to what Chrysler and BMW
roved several years
go: Done right, small cars can make money. The PT Cruiser, built on the underpinnings of the Neon, was a hit when it launched in early 2000. The Mini proved that stylish compacts are no fluke—and that they can sell for as much as $30,000.

The PT Cruiser's success prompted General Motors Corp. Vice-Chairman Robert A. Lutz to develop the Chevrolet HHR, a rival retro compact wagon which hit the market in July. Lutz, who came up with the PT Cruiser back in his Chrysler days, is boasting strong initial sales numbers, saying the HHR is on a pace to beat its 60,000-a-year target. Insiders say GM dumped plenty into rental fleets. But Lutz claims GM sees enough demand to double production. "There used to be a view that no one cared about small cars, but that's a defeatist's strategy," Lutz says.

To make their pint-size offerings more profitable—and to hedge against continued stratospheric fuel prices—auto makers are putting more resources into small-car development. Take Chrysler, which is betting its trio of more aggressively styled cars will sell more for their fashion than their fuel economy. Next year the Neon plant in Belvedere, Ill., will stop making tinny boxes and start building three new models: the Dodge Caliber, Jeep Patriot, and Jeep Compass. Chrysler figures all three can fetch fatter prices than the Neon ever did. "Conventional wisdom says you can't make money selling small cars," says Jeep Vice-President Jeff Bell. "We're defying conventional wisdom."

THE STAT

18%

Small-car share of U.S. auto market, up from 13.6% a year ago

Data Edmunds.com

Some companies even think subcompacts can thrive in the U.S. Jed Connelly, Nissan North America's senior vice-president for sales, says the company's Versa subcompact, which is smaller than the compact Nissan Sentra and is built on the frame of the European Renault Clio, should pull in buyers who have been looking at used cars. Honda Motor Co., just launching its new Civic, will make a similar play with the Fit hatchback. Toyota also will bring out the Yaris subcompact. All three will sell in the $13,000 range.

Cars like the Versa and Fit may only sell in big numbers if gasoline prices stay above $3 a gallon well into next year. "There seems to be some growth in this market," says Connelly. "I don't know if it will last." But other carmakers are trading on style—and that will sell no matter what. ■

–By David Welch in Detroit

EP COMPASS
rysler's next-generation Jeep, with its
ɔy racer" looks, promises to bring
me street smarts to an off-road icon
ICE: NA
PG: NA

DODGE CALIBER
Say goodbye to the boring Neon and hello to this brawny replacement, which resembles the Magnum wagon
PRICE: NA
MPG: 34

HONDA FIT
The small five-door wagon could give young buyers a thrifty option to low-priced Korean cars
PRICE: $13,000
MPG: UP TO 40

TAG TEAM For McNealy and Schmidt, a nice fit

THE INTERNET

A DEAL PREGNANT WITH POSSIBILITY

A Google-Sun alliance could one day loosen Microsoft's hold on the PC industry

IT WAS A CHANCE FOR MICROsoft's many rivals to dream. Google Inc., Microsoft Corp.'s current archenemy and perhaps its most dangerous to date, teamed up with a fierce rival of yesteryear, Sun Microsystems Inc., on Oct. 4. Despite high expectations, the companies agreed to just a modest software-bundling deal, with Sun planning to offer some Google technology to its customers.

But what the announcement lacked in substance, it made up for in possibility. Google CEO Eric E. Schmidt and Sun CEO Scott G. McNealy vowed to promote each other's technologies, including Google's search, Sun's Java software for the desktop, and an open-source suite of office applications dubbed OpenOffice.org. The vague promise: to align more tightly the three biggest threats to Microsoft: Google, Java, and open-source software.

If reality approaches the grand proclamations, it could mean a more concerted effort to break Microsoft's lock on desktops. Some analysts expect Google to challenge many of Microsoft's strongest products, such as Office, its suite of word-processing and spreadsheet applications, with software that resides on the Net. "Google is recrafting itself from a search company to a broad-based services company," says Dwight B. Davis, software analyst at Summit Strategies Inc. A deeper alignment with Sun and OpenOffice could hasten that shift.

What exactly does this mean? No specifics have been unveiled, and its possible the partnership will amount to little. But one scenario has Google helping to promote and distribute OpenOffice and then tightly integrating it with its own search toolbar. Google's toolbar—the technology that Sun will begin to distribute—is a tiny software application users download to search the Web without going first to Google's home page. Some analysts speculate that Google could use the toolbar as a foundation to a Web-based programming world, giving users a way to sidestep expensive PC programs.

The biggest threat to Microsoft: A rival, Web-based ecosystem

To become a real threat to Microsoft's desktop dominance, Google and its allies would have to offer much more than just an Office alternativ The more software app that move online, i stead of residing o Windows machines, th more Microsoft's position in the compu ing universe is threatened. That could su face in forms such as an online music ser ice or an online product that lets use showcase a slideshow from a recen family vacation. Already, key busine applications are hosted online, with Sale force.com's customer-relationship ma agement application leading the way.

Instead of buying software and i stalling it, users would turn to Google an others to rent programs delivered fro anywhere on the Internet to any Web connected device. "It's Competition 101 says former Sun exec Shahin Khan, no marketing chief at startup Azul System "You want to commoditize what you competition is good at, and the Intern turns what Microsoft's good at—distribu tion of software—into a commodity."

"DEDICATED"

THAT'S WHERE SUN'S JAVA technolog comes in. It's used by millions of deve opers to create programs. And those ap plications can run on almost any opera ing system, along with cell phones an other devices. "Both companies are ded cated to software as a service, to netwo as the computer," says McNealy.

Perhaps one day Java developers w write programs that will run on top Google technology, such as the toolbar. I this possibility that's a threat to Microso After all, Microsoft's strength comes fro that sort of ecosystem: As millions of d velopers create programs f Windows, Windows itse becomes ever more key.

The threat to Microsoft hardly immediate, even Google throws its remar able brand strength behi an alternative. Windows an Office hold more than 90 of their respective markets the U.S. "Microsoft's bigge competition is people hol ing on to older versions of i software," says Laura DiDi research fellow at Yankee Group.

But if the partnership sparks a wave applications delivered over the Web, could loosen Microsoft's hold on PCs. Th Oct. 4 deal may have lacked blueprints make it happen. But it didn't fall short offering Microsoft rivals that hope. ■

–By Ben Elgin with Peter Burro in San Mateo, Ca

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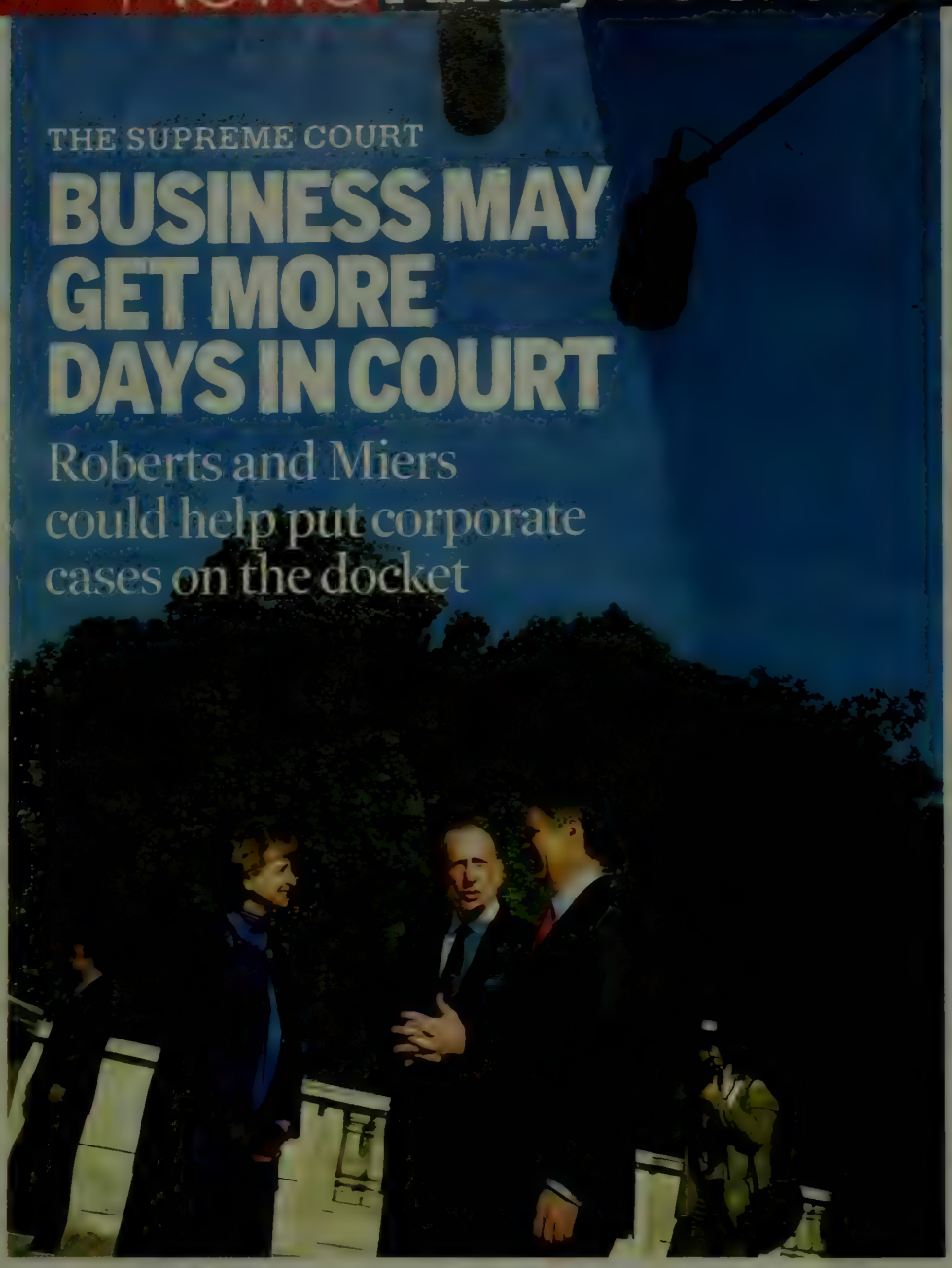
THE SUPREME COURT

BUSINESS MAY GET MORE DAYS IN COURT

Roberts and Miers could help put corporate cases on the docket



ON THE HILL Miers with Senators Arlen Specter and Bill Frist

ON OCT. 3, AS CHIEF JUSTICE John G. Roberts Jr. presided over his first day at the Supreme Court, President George W. Bush was in the West Wing introducing the woman who might soon take her own seat on the court—White House Counsel Harriet Miers. "Senators of both parties will find that Harriet Miers' talent, experience, and judicial philosophy make her a superb choice," Bush said, kicking off the lobbying drive for his surprise pick.

Clearly, not everyone, including members of Bush's own base, shares that opinion. But one segment of American society is cheering: Big Business. Sensing that Miers might be a boon, the boardroom set is hoping her confirmation could herald a sea change on the high court. The addition of Roberts, who spent years as a corporate litigator, was heartening to them. The prospect of Miers, who has defended the likes of Microsoft Corp. and Walt Disney Co. and has been a leading advocate for tort reform, has many executives downright giddy.

No one knows how Miers might vote on key issues such as federal preemption of state law or caps on damage awards. What's important is that she and Roberts bring a one-two punch of practical business experience to the bench. That won't necessarily always mean a win for business. Rather, execs hope their real-world perspective will help them persuade the high court's other justices to hear more cases of interest to business. The expectation is that the duo will help reverse a trend set by the Rehnquist Court, which had little appetite for such cases. "The court takes less than 2% of the cases that come its way. Of that 2%, very few are business cases, the ones that get cepted are critic says Robin Conra senior vice-presid at the U.S. Chamber of Comme "That's where we think a John Robert a Harriet Miers could be most helpful

Indeed, one of the defining charac istics of the Rehnquist Court was its l of zeal for resolving conflicting app court opinions. These circuit court sp have dogged business for years as it watched the high court repeatedly reb appeals to settle conflicts in such areas federal preemption and antitrust. T benign neglect has allowed the natio 10 circuit courts to effectively establ different rules of engagement for diff ent parts of the country. "You end up i situation in which whether you win lose depends solely on where the case brought," says Gregory Coleman, a pa ner at Weil, Gotshal & Manges LLP Austin. "It creates this huge pressure forum-shopping."

SAFETY STANDARDS

THE CURRENT STATE of affairs mea actions that are acceptable in one part the country might be unacceptable in a other. Case in point: the hundreds product-liability lawsuits filed every y in state courts that seek to hold com nies to a standard above and beyond fe eral safety regulations. In one pendi case, consumers sued Nokia Corp. Louisiana, claiming that the radio f quencies emitted by its phones were "u reasonably dangerous" despite t phone's compliance with federal saf standards. The lower court found th oversight of the technical aspects of wi less communications traditionally falls federal, not state, regulators. The U Court of Appeals for the Fourth Circ disagreed, creating a conflict with a d ferent ruling from the Seventh Circuit a similar issue. Nokia has asked t Supreme Court to use the case to clar when a federal regulatory scheme c preempt a tort claim in state courts.

Circuit splits are nothing new, but t patchwork of case law gives compani that operate nationally a particul headache. Miers and Roberts can't sol the problem on their own; they bri only two of the four votes required for t high court to accept a case. But busine hopes that they will persuade other ju tices to hear critical appeals that mig otherwise be rejected. "The court benef from having someone who knows wh it's like out there," says Nathan Hecht,

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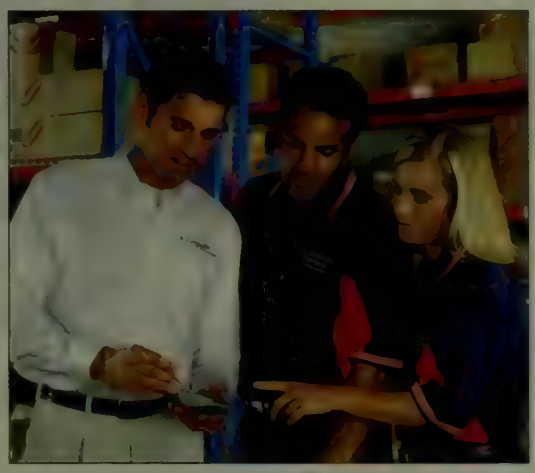

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Texas Supreme Court justice and longtime friend of Miers. "She understands the realities of the legal world, how litigation costs people and what it does to their businesses."

Corporations also are grappling with the high court's refusal to hear disputes over the certification of class actions. Massive class-action injury claims can become bet-the-company lawsuits, often leading to huge settlements if a company's lawyers can't convince a judge that plaintiffs have too little in common to be designated a class. Despite a statute explicitly making it easier to appeal class-certification complaints to the Supreme Court, the justices have demurred, most recently turning back a class-action dispute in 2004.

TORT REFORMER

EVEN AS CRITICS bemoan Miers' lack of bench experience, she brings critical expertise in one key area dear to many executives: tort reform. Back in Texas she was on the front lines of the tort-reform revolution in 1988 when she helped Hecht win election to the Texas Supreme Court. He is credited with spearheading the tort-reform movement in the Lone Star State. Miers was on the campaign trail again in 1994, this time throwing her support behind Raul A. Gonzalez, a tort reform-minded Democrat who was facing a tough primary in his bid to retain his seat on the Texas Supreme Court. A year later the Texas Civil Justice League hired her to lobby for legislation to cap punitive damage awards and discourage medical malpractice claims. But it was a short-lived gig. Miers felt uneasy lobbying her former client, George W. Bush, who had just been elected governor, and withdrew.

DAY ONE Roberts, with Justice John Paul Stevens, spent years as a litigator

In recent years, as the top White House lawyer, Miers has been intimately involved in the Administration's drive to limit jury awards, create an asbesto claims trust fund, and pa business-friendly rules fo class actions. In April sh spoke at an annual meetin of the American Tort Refor Assn., delivering a crowd pleasing rallying cry to tal on plaintiffs' lawyers.

Given that history, Mier more than the other hig court justices, could b amenable to considering ca es involving limits on pun tive damages or class certi cation. Since gaining a 200 Supreme Court victory i *State Farm Mutual Autom bile Insurance Co. v. Campbe* which set caps on punitiv damages, business has see lower courts poke holes i the high court ruling. Despi Big Business' entreaties, th high court so far has declin to revisit the issue.

Miers allies of all strip compare her to another pro-busine judge: Justice Sandra Day O'Conno long the court's swing vote and a fount pragmatism. Miers "will fill the role th O'Connor is leaving," says Tom Dunnin a Dallas insurance executive, Democra activist, and longtime friend. "She w decide cases from a legal standpoint, n from her personal feelings." Others c her an "originalist" who will decide di putes based on a broad reading of the le ter of the law without confining herself a strict constructionist interpretation à Justice Clarence Thomas. That's b news for the GOP's right wing, many whom swiftly denounced Miers' nomin tion, but good news for pragmatis minded executives.

The Right might not like her, but Mie wins praise from many on the Left wh know her. "The biggest compliment ever heard about a lawyer is: You ca shoot dice with him over the phone," sa Franklin Jones Jr., a Marshall (Tex.) tri attorney and self-described "bom throwing" Democrat. "The only proble with that description is that she's prob bly too virtuous to shoot dice."

That penchant for straight-shooti will come in handy on a divided hig court. But beyond that, many executiv are hoping that the business-savvy pairi of Roberts and Miers might herald a n day—and finally give corporate intere their day in court. ■

–By Lorraine Woellert, with Richard Dunham, in Washingt

Friends on the Court

The Rehnquist Court's reluctance to take on business cases led to varying legal standards across the U.S. on key issues. That could change with former corporate lawyers John Roberts and Harriet Miers on the bench. Some examples:

FEDERAL PREEMPTION When do federal standards override claims made in state courts? Federal circuit courts disagree, creating different rules for various parts of the country and for different industries, such as rail and telecommunications. Companies want a single national standard. A case involving Nokia could help resolve the matter.

RETIREMENT What are companies' pension obligations? Pirelli Armstrong Tire was sued when it cut retirement benefits after telling workers pensions wouldn't change. The Fourth Circuit ruled against Pirelli, but the Eighth Circuit, in a similar case, granted companies more leeway. The high court declined to hear Pirelli's appeal. Business wants another chance.

ANTITRUST What is restraint of trade? How is a monopoly defined? Given the vague wording of antitrust statutes, courts have given conflicting answers. Business hopes the Roberts Court will be more inclined than the Rehnquist Court to take these cases and resolve the discrepancies.

INTERSTATE COMMERCE Must an animal cross state lines to be protected by the Endangered Species Act? Courts differ on how broadly Congress can use its power over commerce among states to, say, regulate the environment. Business wants uniform environmental enforcement.

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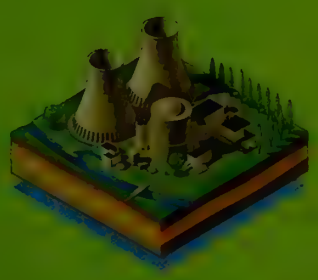

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EDITED BY MONICA GAGNIER

HEADLINER

RICK WAGONER

PEDAL TO THE METAL

The pressure is ratcheting up on General Motors Chairman Richard Wagoner Jr. Billionaire Kirk Kerkorian has raised his stake in the auto maker to nearly 10% and wants a board seat, most likely for deputy Jerry York. At the same time, Wagoner is coming down to the wire in talks with the United Auto Workers about cutting GM's $5.6 billion annual tab for health-care costs. In exchange, the union wants GM to help bail out Delphi and save the jobs of UAW members who work for the parts maker.

If a deal isn't struck before Oct. 17, Delphi could file Chapter 11. That means GM would have to absorb some of its former subsidiary's pension and retiree costs. There are signs a deal may be in the works: On Oct. 4, GM said it will sell its 20% stake in Japanese Fuji Heavy Industries, Subaru's parent. That should raise around $725 million, which could help GM fund Delphi's fix-it plan and buy out some of the auto maker's own excess workers.

–David Welch

A PICK-ME-UP FOR MERCK

Oct. 6. brought some much-needed good news for **Merck**. The embattled drugmaker released data on a new vaccine called Gardasil aimed at preventing infection by the human papilloma virus, a cause of cervical cancer. In the study, which followed more than 12,000 women between 16 and 26, Gardasil prevented precancerous lesions and cervical cancer in 100% of vaccinated women. The vaccine, which could hit the market in 2006, is expected by many analysts to become a $1 billion-plus product. The drugmaker, which is fending off thousands of lawsuits over its withdrawn painkiller Vioxx, desperately needs a hit.

CHIP OFF THE OLD REDSTONE

Succession planning doesn't have to leave home if you're Sumner Redstone. The 82-year-old **Viacom** chairman and majority shareholder will make daughter Shari vice-chairman of both Viacom and **CBS** when the two split sometime next year. The elder Redstone, who will continue to own 71.2% of the companies upon their split, will be chairman. Leslie Moonves will be CEO of the CBS unit, which will include the **Infinity Broadcasting** radio chain, while longtime **MTV** boss Tom Freston will be CEO of the remaining Viacom, which will include its cable channels and Paramount Pictures studio. Shari, 51, who runs the family-owned **National Amusements** theater chain, has long been viewed as her father's heir apparent despite his statements to the contrary.

IS MICROSOFT BEHAVING?

Eighteen months after ruling that **Microsoft** violated antitrust laws, the **European Commission** has finally appointed a computer scientist to help determine if the company is complying with ordered remedies. Neil Barrett is a visiting professor at Britain's Cranfield University and serves as technical director for London consultancy **Information Risk Management.** He will advise, not decide, if Microsoft is meeting the terms of the antitrust finding, which required the company to release a version of Windows without Media Player and reveal secret communication protocols between Windows servers and PCs. Some critics are unhappy with Microsoft's compliance, despite a deal it reached with the EC last June to obey the decision.

P&G: STORM AND STRESS

Headquarters for **Procter & Gamble** is some 800 miles from New Orleans, but the back-to-back hurricanes in the Gulf Coast are being felt in Cincinnati. On Oct. 4, **Citigroup** downgraded **P&G** stock to "hold" from "buy" in part because raw material costs soared after Katrina and then Rita shut down energy and chemical production. **Bear Stearns** in September trimmed its forecast for P&G's fiscal first quarter for similar reasons. P&G, which uses oil and natural gas derivatives to make its products, concedes that earnings will be reduced by the hurricanes, but says that higher sales and cost-cutting will help it make up the difference.

ET CETERA...

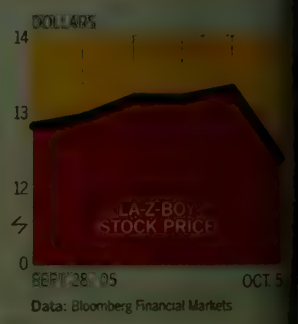
>> **Freddie Mac** said it will buy back $2 billion common and $2 billion preferred shares.

>> **Yum! Brands** reported a 16% third-quarter earnings gain and raised its yearly forecast.

>> **FedEx** will raise its overnight delivery rates by 3.5% beginning next year.

CLOSING BELL

The recent hurricanes have taken some of the comfort out of La-Z-Boy's growth. The furniture maker's shares reclined 7% on Oct. 5, to $12.37, on the news that it would miss quarterly earnings targets. La-Z-Boy is dealing with a foam padding shortage and plant damage.



Data: Bloomberg Financial Markets

THE RESILIENT INFRASTRUCTURE: A GUIDE FOR THE FEARLESS.

For today's enterprise, the only constant is change. And keeping up with change is the ultimate challenge for a business faced with an endless series of paradoxes: making information both secure and available; being reactive and proactive simultaneously; responding quickly to both new threats and new ideas. The solution? A resilient infrastructure that lets you respond as rapidly to opportunity and innovation as you do to threats and disruptions; and where the elements that help keep your company up, running and growing — security, storage and recovery — are firmly in place. This is the ideal that has brought together Symantec and VERITAS to form a single company with a single goal: to help you build a fearless enterprise. For more information visit www.symantec.com/RI.

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DITED BY RICHARD S. DUNHAM

Why Treasury's Next Chief Won't Be a CEO

YEAR AGO, ADMINISTRATION hard-liners tried to force out Treasury ecretary John W. Snow by leaking reports of his imminent ister to the media. The rap: The former business chieftain was o pragmatic—and deficit-obsessed—to play a starring role on supply-side squad. Unfortunately for them, the plotters forgot tell President Bush, who rallied behind ow. The ex-CEO of CSX got to stay on, ping to lead the ill-fated push for So- l Security private accounts. Now, the k is that Snow, 66, will voluntarily de- t not long after he tidies up a last bit of tstanding business—handing his boss Nov. 1 recommendations of a biparti- commission that's weighing tax-re- m options.

It's clear from the internal chatter that next chief is almost certainly going e cut from a different bolt of pin- pes than the two CEOs who have d the top Treasury job. Former Al- boss Paul H. O'Neill, an outspoken verick, was dumped in 2002. Snow, enial traveling salesman for Team Bush, endured sniping from critics who nk he falls short as a key policymaker. ite House insiders say the President is lined to junk the industrialist model in osing his next Treasury chief.

BUSH LOYALISTS Budget Director Bolten and Chief of Staff Card

In most of his second-term appoint- nts, Bush has shown an inclination to ard trusted insiders with key jobs. ong them are Secretary of State Con- eezza Rice, Attorney General Alberto R. nzales, Education Secretary Margaret llings, and now Supreme Court nomi- Harriet E. Miers. Two low-profile loyal- fit the bill to succeed Snow: Budget Director Joshua B. Bolten, a former Goldman Sachs executive whom insiders say is not happy with his job, and Chief of Staff Andrew H. Card Jr., Transportation Secretary under the first President Bush. "The President is comfortable with these guys," says one adviser.

One drawback to Card: His nomination could upset the currency markets because he was an advocate for a weaker dollar when he lobbied for the automobile industry in the mid-1990s.

Bolten's downside? He shuns the limelight and might not be at ease in the role of chief economic spokesman. Besides, Bush may prefer to have him just down the hall as his next chief of staff.

If he wants a policy wonk with a track record of loyalty, the logical choice is R. Glenn Hubbard, dean of Columbia Business School and a *BusinessWeek* columnist. Hubbard, who served as White House chief economist in the first term, was the architect of Bush's plan to slash taxes on dividends and capital gains. He's also in the running to be chairman of the Federal Reserve when Alan Greenspan steps down next year.

A Wall Streeter at Treasury also could help fill the void left by Greenspan. Two financial industry veterans in the mix are Goldman Sachs CEO Henry M. Paulson Jr. and Merrill Lynch CEO Stan O'Neal. But the smart money—inside and outside the Administration—is betting that confronted with these choices, Bush will forgo the big name in lights and opt for the comfort of a lieutenant he can trust. ■

–By Rich Miller

CAPITAL WRAPUP

AN OLD CHINA HAWK'S NEW MISSION

AS A CONSERVATIVE GOP congressman from Southern California, **Christopher Cox** blasted the Chinese government for trampling on its people's political freedom. Now, as the new chairman of the Securities & Exchange Commission, Cox will press Beijing to safeguard a different kind of freedom—the kind that could foster the growth of its nascent capital markets.

In a mid-October visit to China, his first trip abroad as SEC chief, Cox promises to preach the gospel of disclosure, transparency, and good corporate governance. "There is a relationship between the freedom of information and transparent capital markets," says Cox. "Frictionless markets require information as a lubricant." He intends to prod Chinese regulators to adopt international financial reporting standards and help combat securities fraud in global markets. And Wall Streeters hope he'll address Beijing's insistence on a controlling interest in financial joint ventures. *–Amy Borrus*

WHEN IS A BUDGET CUT NOT A BUDGET CUT

THE SENATE Appropriations Committee claims to have trimmed **President Bush's** Pentagon spending request for 2006 by $7 billion. In reality lawmakers shifted some of the spending to a supplemental bill for the Iraq War. That's not the only accounting sleight-of-hand. The committee moved $10 billion in future retiree health benefits costs from the Pentagon to the Treasury Dept. The nonpartisan Congressional Budget Office blew the whistle on the gambit, leaving the committee $10 billion over the mandated defense spending cap of $439 billion.

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Building Business Around Customers:

Let Customers Lead the Way

Most executives would agree that building a customer-focused business makes good financial sense. After all, customers are the ones who pay the bills, select your company over the competition, and generate value for your shareholders. To be sure, every company focuses to some extent on its customers. But there is a key distinction—often missed—between merely considering one's customers and building a business around them.

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In too many businesses, "focusing on the customer" has come to mean little more than high-level speculation about customer needs and preferences, often by well-intentioned people who nevertheless have had little contact with real customers. Even when actual customer opinions are collected, they are frequently forced to fit within a preexisting corporate mindset, with contradictory or inconvenient input quietly set aside.

Designing Around Customer Needs

One company that has truly built its business around customers is Virgin Mobile USA. A joint venture between Virgin Group and Sprint, Virgin Mobile is the first mobile virtual network operator (MVNO) in the United States—and the nation's first wireless service to solely target the youth market. Not only did Virgin Mobile reach its 3 million customer milestone in less than three years, but it has posted a stellar customer service rating: More than 90% of Virgin Mobile customers say that they would recommend the service to their friends.

How has the company achieved such impressive results in a short period of time—operating, no less, against some very entrenched competitors? Two principles are at play. First, Virgin Mobile USA realized early on that providing the best customer service in the industry would be vital to its success. "We are fundamentally different from any other operator in North America," says Mike Parks, CIO, Virgin Mobile USA. "Although we are running on top of the Sprint network, everything that happens—in terms of customers' interactions with our user interface, Web site, and customer care environment—is supported by systems that Virgin Mobile, working closely with technology partner Patni, integrated, built, or customized, resulting in a uniquely Virgin Mobile experience."

Second, Virgin Mobile listens carefully to its customers—and designs its products accordingly. One key feature: a low-price-of-entry, pay-as-you-go plan that's perfectly suited for young adult budgets and aversions to long commitments. "Because we are Pay As You Go, we need to be very real time. If a customer's balance goes to zero, they want to put additional money into their account and make another call instantaneously—they don't want to wait 24 hours. Our Siebel-based customer management system enables us to meet these demands and deliver a truly 'now' offering."

If that wasn't enough, Virgin Mobile packs each of its phones with the extras that young people most want: two-way text messaging, fun content from the likes of MTV and Comedy Central, and even a "rescue ring" to extricate users from unpleasant social situations.

If customer satisfaction numbers are any indication, Virgin Mobile users must like the results. "Customer service is our most important measure of success," explains Parks. And that success, to coin a phrase, speaks for itself.

To learn more about how leading companies are building their business around customers, please visit www.businessweek.com/go/customer and www.siebel.com/thecustomer.

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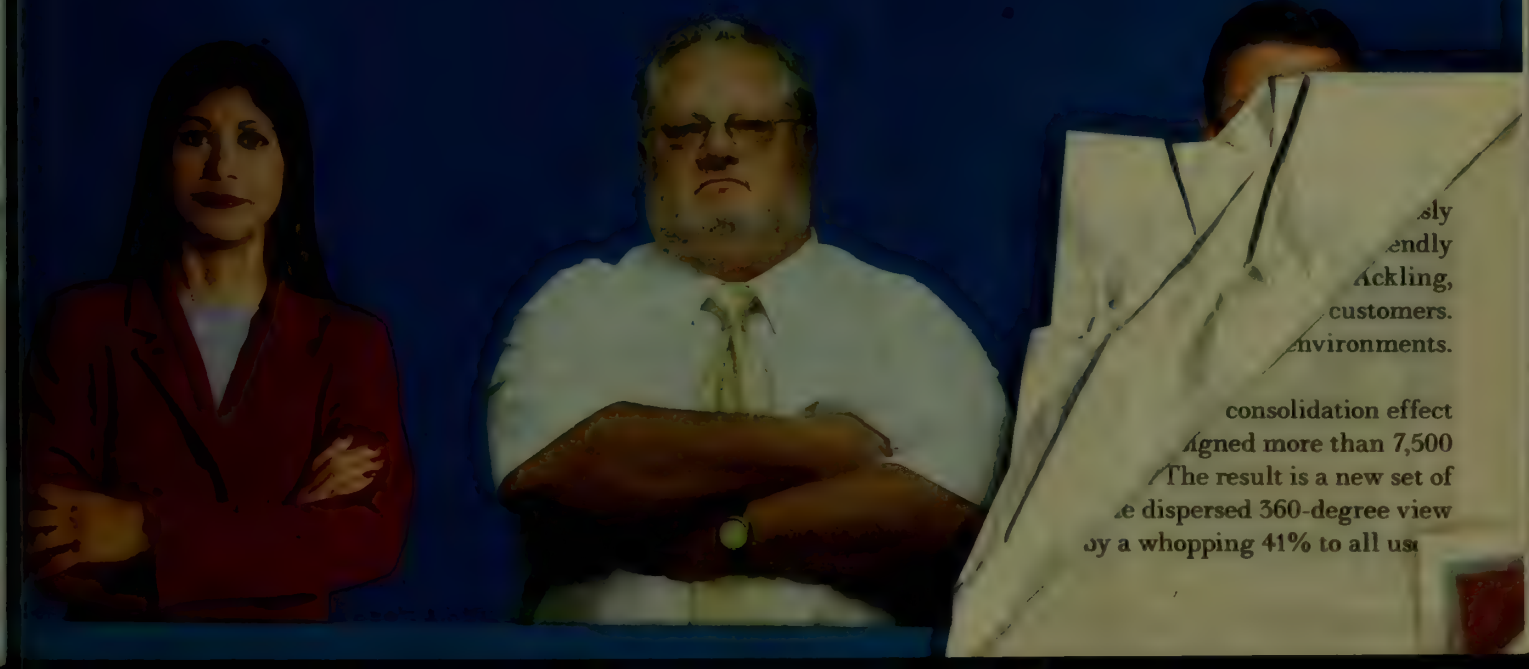

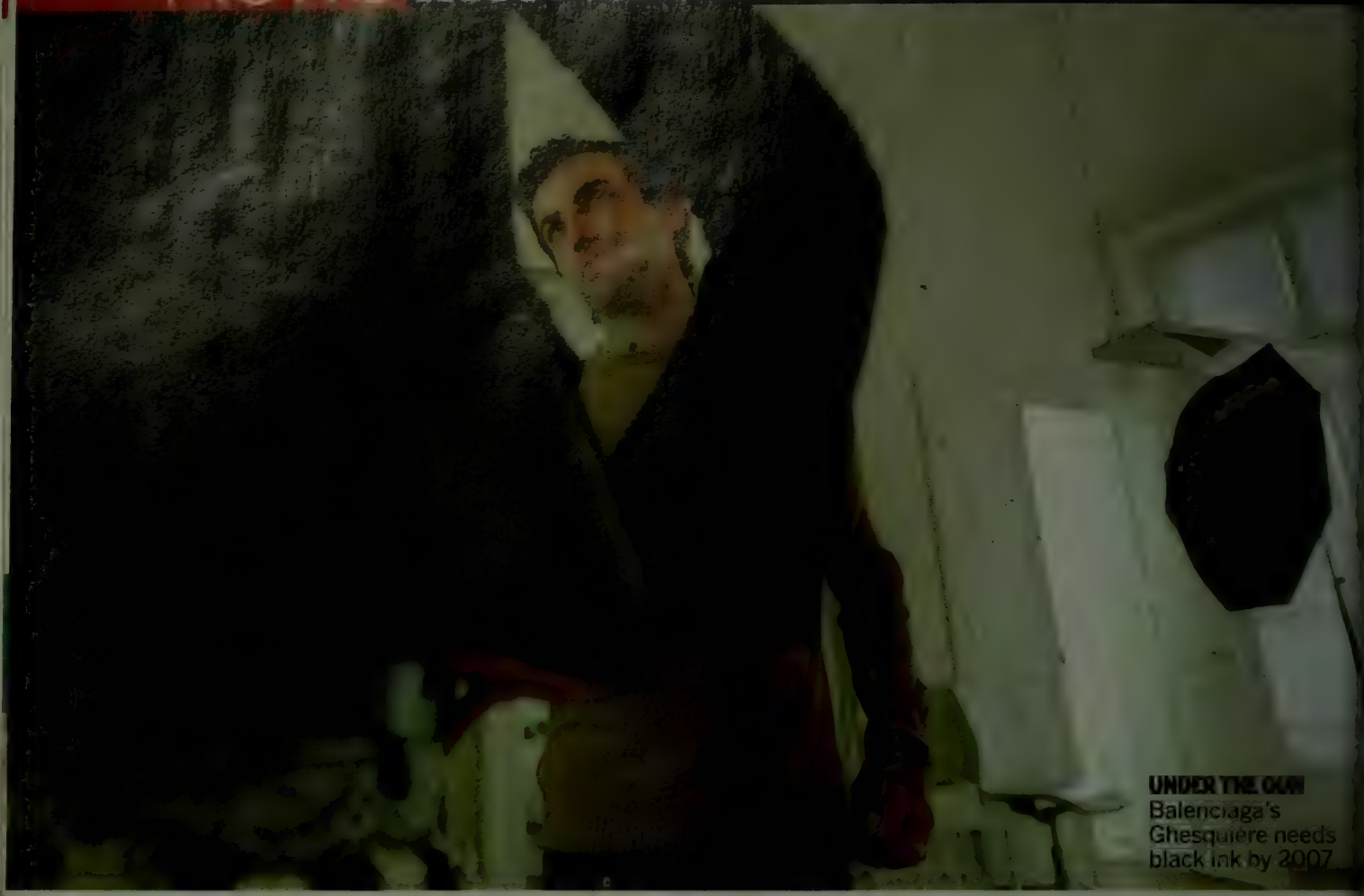

UNDER THE GUN Balenciaga's Ghesquière needs black ink by 2007

EUROPE

TIGHTER BELTS ARE IN FASHION

Global luxury houses are looking to cut loose their unprofitable labels

KNEELING ON THE FLOOR of his studio at Paris fashion house Balenciaga, Nicolas Ghesquière stares intently at a lacy sleeve on a model's arm. An assistant stands by, ready to whisk away the detached sleeve so it can be stitched onto an evening gown. Balenciaga's Oct. 4 ready-to-wear show is less than 48 hours away, and Ghesquière's face is etched with fatigue. The studio is filled with leggy models waiting for final fittings. Yet the place is eerily quiet, mirroring Ghesquière's intense focus as he gently tugs on the filmy fabric to make sure the sleeve hangs from the shoulder in a fluid line. It's that kind of attention to detail that has made Ghesquière, 34, a fashion superstar, according to *Vogue* and others.

Yet the runway show is only part of the pressure Ghesquière faces. Gucci Group, which acquired the storied fashion house of Balenciaga in 2001, recently an nounced that it will put the company for sale if it doesn't turn a profit by 200 Balenciaga had been losing money w before Ghesquière became its chief d signer in 1997. Together with Gucci CE Robert Polet, the designer has hammer out a plan, and both say the recovery is o track, with a 115% sales increase duri the first six months of 2005 over the sa period in 2004. But Ghesquière adm that when he first took up fashion desi he never foresaw spending hours budget meetings. "The rules ha changed," he says. "Now you have to g involved in the strategy of the house."

RAG-TRADE REALITY

GHESQUIÈRE IS FEELING the effects years of overindulgence by the luxur goods industry. Fueled by double-dig sales growth through much of the 1990 global groups such as Gucci, Prada, an LVMH Moët Hennessy Louis Vuitto loaded up on prestigious but profitle brands. Gucci's purchases included Ba lenciaga, Yves St. Laurent, and the Stel McCartney, and Alexander McQueen la bels. LVMH picked up Fendi and Emili Pucci, Prada took Jil Sander and Helmu Lang. The groups figured that wit the right knowhow they could replica

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their flagship brands' success.

Yet turning around the new acquisitions has proved more costly and time-consuming than expected, a task complicated by the post-September 11 slump in luxury-good sales and the strengthening the euro. During the first half of 2005, cci's six smallest brands, including Baciaga, McCartney, and McQueen, post- a $30.9 million loss on $160 million in es. McCartney and McQueen also have n warned that their brands will be sold ney aren't profitable by 2007.

The financial squeeze intensified just as esquière was achieving global recogion for reviving Balenciaga, a legdary couture house that had lanshed since the retirement of founder stóbal Balenciaga in 1968. After a stint Jean-Paul Gaultier, Ghesquière had ned Balenciaga at age 23. When the ef designer was fired two years later, esquière got the job. It wasn't long be- e his designs were drawing rave rews from the fashion press, and his eletly cut, pencil-slim trousers began ning up on stars such as Nicole Kidn and Chloe Sevigny. Then Gucci's den chief Tom Ford and CEO Domenico Sole approached. "They offered supt, logistics, a broad shoulder to lean " Ghesquière recalls.

But the relationship soon grew tense. d and De Sole wanted Ghesquière to e the atelier, a workroom on the upper r of Balenciaga's Left Bank townhouse ere eight employees turn out protoes of designs and experiment with fab and tailoring. Gucci considered this nnecessary expense since its factories taly provide such services. Ghesquière ued that taking the atelier away would ike robbing a scientist of his laboratoGucci relented, but then told the designer that it would no longer finance his runway shows, forcing Balenciaga to stage small shows at headquarters. Ghesquière was ready to call it quits when in late 2003 Gucci announced De Sole's and Ford's departure. Ghesquière says he has a more cordial relationship with Polet, who was named Gucci CEO by parent PPR Group. But Polet, a former Unilever executive, admits to being a tough boss: "I told him, 'You are going to have to make a profit, or you will close.'"

The two men struck a deal: Ghesquière could keep his atelier, but he would have to hold the line on other costs and boost sales. To attract customers, Balenciaga this year introduced "Capsule Collections" of some of its most popular designs, made without the costly embellishments, such as hand-stitched insets, that are often shown on the runway. The price tags range from $345 to $575—well below the $2,000-and-up prices many Balenciaga ready-to-wear creations command. About half of Balenciaga's sales now come from the Capsules and other derivatives of runway designs. The simpler clothes are quicker to produce, so that Balenciaga can get its merchandise into stores more quickly, as do "cheap-chic" retailers such as Spain's Zara and Sweden's H&M Hennes & Mauritz. The more often new clothes arrive, the more often customers come in, increasing the odds they'll spurge on something like a $7,200 fur-trimmed coat, a Balenciaga best-seller.

SHOULDERING ON A gown from Balenciaga's 2006 lineup

Balenciaga has also scaled back plans to open its own boutiques, opting instead to set up shop at upscale retailers such as Barneys in New York and Harvey Nichols in London. To compensate for a slim advertising budget, Ghesquière generates free publicity by making discreet gifts to celebrities. This strategy has helped it drive sales of Balenciaga's Lariat handbag. "Nicolas really does have a business head," says James McArthur, a senior Gucci executive who recently became CEO of Balenciaga .

Could Balenciaga turn profitable even before 2007? The reaction to Ghesquière's Oct. 4 show bodes well. "C'est magnifique," *Women's Wear Daily* said of the collection, a mix of frothy gowns and sleek pantsuits with baroque collars. Adding to the buzz, the Paris Museum of Fashion & Textiles is planning a major Balenciaga retrospective. That's likely to spur demand for updates of classic designs that Ghesquière is selling under the Balenciaga Edition label. As Ghesquière is learning, even the ritziest clothes look better beside a beautiful balance sheet. ■

–By Carol Matlack in Paris

Gucci Group's Profitability Gap

While the flagship spins profits, most of Gucci's smaller brands lose money*

GUCCI	BOTTEGA VENETA	YVES SAINT-LAURENT	YSL BEAUTE	OTHER BRANDS**
$228.4 MILLION	$2.5 MILLION	-$48.2 MILLION	-$22.6 MILLION	-$30.9 MILLION

*1H 2005 operating earnings **Balenciaga, Bédat & Co., Boucheron, Stella McCartney, Alexander McQueen, Sergio Rossi Data: PPR Group

GERMANY

MERCEDES' NEW BOSS ROLLS UP HIS SLEEVES

Layoffs are just the beginning. Can Zetsche fix production and quality woes?

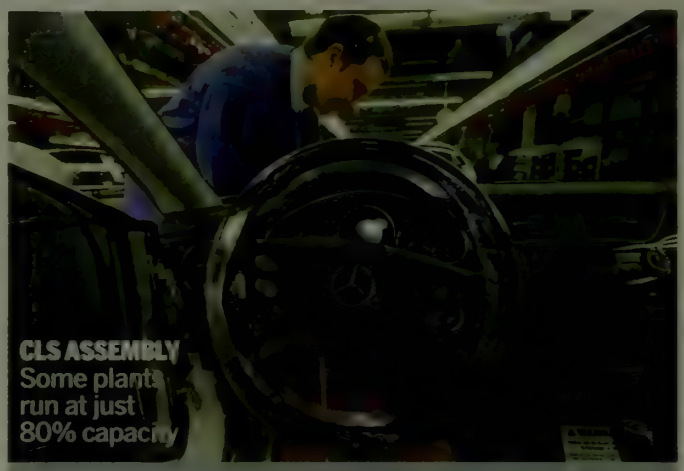
ONLY FOUR WEEKS into the job, Mercedes Car Group chief Dieter Zetsche stunned employees on Sept. 28 by ramming through a program to cut 8,500 jobs at the German auto maker—9% of its German workforce. Zetsche's move heralds a new era at parent DaimlerChrysler, where the affable 52-year-old who turned around Chrysler takes over as CEO on Jan. 1 in addition to his job running Mercedes. "Mercedes has become flabby," says Garel Rhys, director of the Centre for Automotive Industry Research at Cardiff University Business School in Wales. "Management has woken up to the fact that they have to tackle their cost base."

And how. Industry experts estimate the cost of producing a car at Mercedes now runs $2,400 to $3,000 higher on average than at No. 1 luxury carmaker BMW. "Mercedes' whole mantra has been: 'We build the best luxury cars in the world—at any cost,'" says Morgan Stanley analyst Adam Jonas in London.

With Zetsche in the driver's seat, those days are over. "A long hard road lies before us. Our costs in every part of the production chain are clearly higher than those of our best competitors," he said in a Sept. 28 letter to employees. Mercedes lost $1.1 billion in the first half and is likely to finish the year with a loss. Analysts say the job cuts will add momentum to efforts to save $5.6 billion by 2007 and restore an operating margin of 7%, up from analysts' forecast of negative 0.8% this year.

Downsizing the workforce is just the first step. Zetsche's German plants lag behind rivals BMW and Toyota Motor Corp. by a generation in cutting-edge factory design and processes, say analysts. They also figure BMW's plants run at 95% of capacity, vs. 80% at Mercedes' German plants. One reason is declining sales of the E-Class and C-Class models, which have suffered quality problems.

A face-lift for the E-Class in 2006 and a new C-Class expected in late 2007 should help. But union contracts that reduce flexibility are also to blame for the relatively low output. Production lines in the Sindelfingen plant, for example, stop during the lunch hour, while BMW uses staggered lunch breaks to keep its line flowing. In addition, BMW employees work much less during periods of slow demand and bank the unused hours, paying them back during peak periods and thus eliminating a lot of overtime pay. Mercedes only recently instituted more flexible schedules and got union agreement to shuttle workers among plants.



CLS ASSEMBLY Some plants run at just 80% capacity

Decline of an Icon

How Mercedes got caught by spiraling costs

- Management bought labor peace by avoiding job cuts. Now, eliminating 8,500 slots will cost $1.15 billion.
- Quality problems caused warranty costs to explode.
- Fixing quality problems means running production lines at lower speed, crimping factory productivity.
- Engineers design new electronics for each model, adding to complexity and cost.
- Management failed to make incremental improvements in productivity as new models were introduced.
- Sharply declining sales of the E-Class and the C-Class lowered the utilization rates at Mercedes factories because of quality problems.

ELECTRONICS BACKBONE

IMPROVING QUALITY is also vital. The drive to lead in technology has produced cars packed with different electronic systems, which all must be integrated into a core system that functions harmoniously—a hard task. By contrast, BMW has installed common electronics backbones, or architecture, across many model lines. It also saves money by sharing more components among models. Mercedes says its cars use the same electronic architecture but the many parts vary across its array of models.

Zetsche's predecessor, Eckhard Cordes, added hundreds of engineers and slowed production lines to allow for additional testing, but that torpedoed productivity. The real fix lies in designing less complex cars and improving test procedures before model launches. The new $96,000 S-Class will test whether Mercedes has its electronic problems under control. Testers drove 500 new S-Class cars some 5 million miles to search for potential failures.

Redesigning and reengineering all Mercedes models for better quality could take two years or so—assuming Zetsche can push through changes as fast as he would like. "Mercedes needs new products that are engineered with a different philosophy," says James N. Hall, vice president of AutoPacific Inc. in Southfield, Mich. The hardest job will be changing the Mercedes mindset and convincing a proud workforce they have been lapped by the competition. ■

–By Gail Edmondson in Frankfurt

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-200585

CHINA

LET A THOUSAND BRANDS BLOOM

Multinationals are competing with locals for a more discerning Chinese consumer

FIVE YEARS AGO GENERAL Motors Corp. offered just a handful of car models in China—mostly large, high-end Buicks costing around $40,000. That limited selection worked in a market dominated by fleet sales to government offices and enterprises: What these customers wanted were large sedans for hauling around big shots. "We were targeting institutional buyers, who were our big market back then," says Kevin Wale, president of GM China.

Fast-forward to the present, and it's hard to believe that GM is the same company. The auto maker now offers a range of models aimed at various customer segments. For China's newly rich, there are $75,000-plus Cadillac SRX sport-utility vehicles and $55,000 CTS sedans. A bit lower down, the $30,000 Buick Regal is positioned as the vehicle for cost-conscious entrepreneurs who want a prestigious car. For their midlevel managers, there's the $15,000-to-$20,000 Buick Excelle—offered in various models. And for younger urbanites buying their first cars, GM's Chevrolet marq now offers the $19,000 Epica sedan, t $10,000-to-$12,000 Aveo hatchbac and the $5,700 Spark minicar. Mea while, in the countryside the Detroit c maker offers the Wuling, which goes f $4,000 to $6,500. This boxy miniv can carry seven passengers, a couple hogs, or a dozen sacks of potatoes. "W had a very limited product line in Ch na," says Wale, who took over GM's t China job in March. "Now we have extremely well-developed range brands and cars." And they're availal at nearly 1,000 outlets across the cou try, up from just nine in 1998. Add it up and it means lots of metal moving the lot: GM China's vehicle sales th year are expected to grow by 20%.

$37 WASHING MACHINE

GM ISN'T ALONE in discovering that Ch na is not a monolithic market. The cou try, with 1.3 billion citizens speaking mo than 100 dialects, is wildly diverse. Wh people eat, wear, and drive differs great from north to south, east to west, rich poor, young to old, city to countrysid Urumqi in the northwest is further fro Guangzhou in the southeast than Oslo from Rome. "It's clear that you ca treat China as just one country," sa

COST-CONSCIOUS P&G sells two brands of Tide.

PRESTIGIOUS GM aims Buicks at executives

Data: National Bureau of Statistics, China

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Glenn Murphy, managing director of ACNielsen China in Shanghai.

And while it was once enough for companies to focus on the 100 million or so Chinese living in Beijing, Shanghai, Guangzhou, and a handful of other big cities, today they're scrambling to offer products tailored to more segments of the population. That means an explosion of choice for consumers. Appliance- and electronics-maker Samsung has discovered that customers living in steamy Guangdong Province need larger refrigerators than those in the more temperate north, so it started shipping bigger fridges south. Household-goods company Procter & Gamble Co. has won over consumers in China's hinterlands with a budget detergent called Tide Clean White, while holding onto city customers with the more expensive Tide Triple Action. And Nokia Corp. now pumps out scores of phone models aimed at every conceivable type of user, and has more than 100 sales offices in every corner of China, up from just three in 2002. "We were trying to run China by just managing it centrally as one market," says Colin Giles, Nokia's senior vice-president for sales and marketing in China. "When we started to roll out local distributors, we realized how diverse the market really is."

It's not just the multinationals that are segmenting the market. Chinese companies are doing the same. Appliance maker Haier Group, for instance, sells dozens of washing-machine models in China, including a tiny one targeted at rural customers that costs just $37. Lenovo Group Ltd. manufactures not only $2,000 PCs that double as home-entertainment centers, but also simple machines costing a couple of hundred dollars aimed at poorer rural families. And Geely Automotive Ltd. today offers five models, up from just two in 2003. The $17,000 Mybo is marketed as a family sedan, while the $3,700 Haoqing is aimed at recent college grads just buying their first set of wheels.

Learning about these emerging groups of consumers is the No. 1 task for multinational and domestic companies alike. They're meeting it by conducting focus groups and surveys across the country. To succeed in China, you have "to understand the psychographic profile of Chinese consumers, their emotions, and what they identify with in a brand," says Viveca Chan, brand expert and former China head for the advertising agency Grey Global Group. Grey has divided young Chinese into 11 categories—everything from independent types who don't follow consumer trends to shoppers on the cutting edge.

Other companies are spending lots of time with customers. Last spring, GM designers and engineers flew to Guangxi Province to visit van buyers and to see their homes and farms. James Shyr, director of design, recalls sitting on the sidewalk, smoking with drivers and talking about the features they like. "They use their microvans to run around from Monday to Friday hauling a lot of goods, but on the weekend they clean it up and take it for an outing," Shyr says. So Shyr's designers stuck with a utilitarian design better suited to rural lifestyles.

Similarly, Motorola Inc. dispatched teams of researchers to far-flung locales. The company, which stumbled in China two years ago when local r vals started to eat into i market share, discover that even consumers f from the bright lights Shanghai and Beijing a becoming more discernin "In the lower-tier cities, t young people look at valu but they're also very ind vidualistic," says Motoro China boss Michael Tat man. The result: Motoro designers are devoting more time an energy to the lower end of the marke and even the company's least expensi phones allow users to download MP songs and customize ringtones. An while Motorola doesn't design phon specifically for rural China, it is now be ter at getting the right handsets to ea location. "The demographic differenc have always been there, but we've b come more sophisticated in our ability identify them," Tatelman says.

As marketers figure out how to rea China's variegated consumers, ru China looms ever larger. It has so 750 million residents, and in the fi half of this year pe capita incomes in ru areas were up by 12.5 Local rivalry is stiff. W haha, for instance, China's largest bevera producer because it d veloped its distributi in rural areas. Wahaha marketing sometim consists of simp painting the company logo on village walls.

Yet the multination keep getting more s phisticated in tailori their message for bo urban and rural co sumers. P&G, for i stance, reaches Chin city strivers by sponsoring a popular r ality TV show called *Absolute Challen* which has contestants vying to win jo as product representatives for Crest Cover Girl. At the same time, it blank village kiosks and mom-and-pop sto with advertising emphasizing the va offered by Tide Clean White and low-e versions of Crest and Oil of Olay s cream. Breaking out of China's cities i challenge, but one that more and m companies, local and foreign, know t must take on. ■

–By Dexter Roberts in Beijing a David Rocks in Shangh

Shoppers of all incomes are being wooed in rural and urban areas

Segmenting China

How top consumer-goods companies are playing the China market

GENERAL MOTORS The car company now targets the wealthiest with the Cadillac, middle management with the Buick Excelle, office workers with the Chevrolet Spark, and rural consumers with the Wuling minivan.

MOTOROLA The phonemaker has deployed thousands of salespeople to flog its handsets deep within China. Motorola designers are devoting more time and energy to the low end of the market, and even the cheapest handsets allow users to download MP3 songs and customize their ringtones.

PROCTER & GAMBLE The packaged-goods maker has developed bargain-priced versions of Tide, Crest, and Oil of Olay, and regularly relies on groups that live in the countryside for consumer information.

HAIER China's top appliance maker makes larger washing machines for Chinese cities, but has also developed a tiny model costing just $37 for poorer areas.

SAMSUNG Its white-goods division discovered that customers living in steamy Guangdong Province in the south needed larger refrigerators than those living in the more temperate north.

Data: Company reports

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It Sure Ain't Old Navy

Gap's new chain, Forth & Towne, is a bet that store design ca lure women 35 and over—and keep them hanging out for awl

IN 2003, WITH SALES JUST RECOVERING from a deep slump, Gap Inc. set its sights on the one slice of the market it wasn't reaching: women 35 and older. But executives knew that a new brand had to offer far more than the loose-fitting tunics and pants with roomy waistbands that are already on the market in abundance. "You can get great-designed clothes at Target if you want," says Gary Muto, president of the company's new brand, called Forth & Towne. "We wanted to create an environment that was distinctive, a place where you'd feel inspired, a place where you'd want to spend time."

The goal was lofty: To create a store so well-designed that it would become for busy Baby Boom women a sort of "third place," a destination other than home or work where people enjoy spending free time. Gap wanted the store's physical space not only to facilitate the sale of clothing but to embody the new brand, much as Starbucks and Apple Stores do. In doing so, Gap is placing a big bet on the growing importance of social shopping, the notion that shopping can be transformed into a pleasurable communal experience.

The first five Forth & Towne stores opened in August at malls in New York State and Chicago, with a range of upscale goods from tailored blazers to blue jeans, priced roughly on par with Gap's Banana Republic brand. Before the doors opened, Muto, chief executive Paul Pressler, and other Gap managers spent three years trying to come up with a design vision that fit their business plan. In the process, they abandoned many of the traditional appointments of a mall store. The result: a bold design by New York architect David Rockwell that places in the middle of each store a grand round "salon" of fitting rooms, furnished like a little hotel lobby. At its center are comfortable chairs and a "style table" laid out with fashion magazines, fresh flowers, and bottles of water. Forth & Towne's success will largely depend on whether women in its target demographic choose to linger in that salon.

It's a necessary gambit for Gap, which posted $16.3 billion in revenue last year. After flagging for almost three years, Gap's same-store sales began to recover in late 2002. But with the market almost saturated with Gap's existing three brands—Gap, Old Navy, and Banana Republic—Pressler needed a new source of long-term sales growth. Pressler's strategy: Launch another outlet, a move that Gap had pulled off before with the opening of Old Navy in 1994.

It may be an architectural success, but it's still too early to know if Forth & Towne will become a billion-dollar brand. The critics Pressler has to face can be more than Rockwell's. "I think it will be successful initially because it's new and different," says Todd Slater, director of research at Lazard LLC. "But long-term I don't think the business has a

DRESSERS' DUMMIES are intended to evoke the design process.

Decoding The Design

The "fitting salon" at Forth & Towne takes center stage, smack in the middle of the store. Here are some of the features designed to make it a fun place to shop and spend some time:

ce of succeeding in its current incar-
›n—not from a design point of view
rom a merchandising point of view.
ı't know that the merchandise out-
›rmed the competition."

ATING BY FEEL

FOR GAP, the experiment hinges as h on how women connect with the ps as with the clothes. Pressler, who to run Walt Disney Co.'s theme park ness, tapped into his former life for his ver. He decided Forth & Towne needed ienie." That's Walt Disney's term for a al magnet—the ur-example of which is ping Beauty Castle, the iconic center- e of Disneyland that guides people nd the park. And he knew just the guy he job. In winter of 2004 he called on kwell, who had worked for Disney dur- Pressler's tenure there. Rockwell de- ed the Animator's Palette, a restaurant on Disney's cruise ships whose lighting, walls, tableware, and wait-staff uniforms morph over the course of the meal from black and white to color, like a cartoon being colored in.

Rockwell is unusual among architects in that he's more interested in how something feels than how it looks. A low-key, affable man who wears his hair long, his architecture is marked by a sense of theatrical extravagance—on display, for instance, in the thousands of abalone shells dangling from the ceiling at Nobu 57, a Manhattan sushi restaurant, and the giant red wig in his set for the Tony-award winning musical *Hairspray*. "The notion was, 'how could we use someone like David to start to think about the store environment as being as important as the clothing?'" says Pressler.

The first step was getting a first-hand understanding of the customer. They invited onto the design team Karen Davidov, the wife of Henry Myerberg, a principal at the Rockwell Architecture, Planning & Design Group, an architect herself and squarely in the target market as a woman in her late 40s. She and Lizzie Sayner, a 31-year-old designer at the Rockwell Group, would visit the Garden State Plaza in Paramus, N.J., to check out the competition—stores like J. Jill, Coldwater Creek, and Ann Taylor. They would snap pictures on the sly, try on clothes, and hang out. "We all had such empathy for this woman," Sayner says of

THE SPARKLING CENTRAL CHANDELIER—recalling the heyday of the department store—is updated as banks of hanging stainless steel rods tipped with clear filament bulbs.

THE CIRCULAR SHAPE of the fitting salon is meant to encourage interaction—like a gazebo in a small-town park.

A REFRIGERATOR tucked off to one side holds bottles of Forth & Towne-labeled water. Chocolates on the table are another come-on.

NARROW, CURTAINED ENTRYWAYS emphasize intimacy, making it conducive to hanging out with friends, other shoppers, men in tow, and Forth & Towne's "style consultants."

EACH FITTING ROOM is decorated uniquely—implying that shoppers aren't simply getting cookie-cutter style.

DECO-STYLE STOOLS encourage lingering; a styling table with accessories and lifestyle magazines are intended to provoke ideas about style in other forms, like gardening or home decor.

(L TO R) PHOTOGRAPHS COURTESY OF GAP; ROCKWELL GROUP/ADRIAN WILSON

the archetypal Forth & Towne shopper.

Sayner and Davidov tried to invent a back story for her, shading in where "she" lives, where she shops and gets style ideas, and how she balances work and family. They decided Forth & Towne had to accommodate a woman with myriad impulses, one who was comfortable in urban and suburban environments, a social shopper but often a harried one.

Sayner pulled touchstone phrases and images into a scrapbook, with categories such as "careers," "friends," "worries," and "what I want." It had photos of Ally McBeal, Condoleezza Rice, and the women from *Dynasty* in the "careers" section. In other sections: a "balanced life quiz" clipped from a magazine; an Amazon.com shopping cart with Norah Jones in it; the cover of *Divine Secrets of the Ya-Ya Sisterhood*; and phrases like, "I have zits, a spare tire, self respect, and dignity." In April of last year they gave the scrapbook, like a gift, to Jenny Ming, brand president of Old Navy and part of the small, high-level team shepherding the Forth & Towne project prior to Muto's appointment.

FOCAL POINT The fitting salo also acts as the store's beacon

FINDING THE CENTER

WITH THE NEW STORE'S DNA established, Rockwell and his team now had to design the actual space. No plan would succeed if it cost $500 a square foot to build—not when hundreds of stores were ultimately envisioned. So there was no room in the budget for giant interactive displays or grand stairways.

As is typical in the design process, the team pondered a variety of possibilities, creating iterations of an idea until it either reached a dead end or was clearly a winner. Execs dismissed a typical mall store's "main street," where racks of clothing are arranged along a central path. They thought of designing "gates," ceremonial entryways to each of the four separate labels of clothing Forth & Towne carries, but that ate up too much floor space.

What every store needed, the designers knew, was an iconic center—something that played the role of a clock tower, a gazebo, or a village green in a small town. In Disney parlance, they needed a wienie. First, they tried using a chandelier to create a central beacon for the store, recalling the heydey of the department store. But "the overarching frustration that women in this segment have is fit," says Muto. "So if you want to be known for having a great-fitting product, and you want them to go to the fitting room, then why not make that experience the best it possibly can be?" So, gone were narrow, anonymous fitting-room hallways. In came the elaborately decorated fitting salon.

With that key design element in place, in January, 2005, Gap built a full-scale mock-up of a section of the store in a warehouse near the San Francisco airport. Over the next several months, working closely with Gap execs, Rockwell fine-tuned the layout there—"like a fashion fitting," Rockwell says.

The last, and perhaps hardest, decision was what color the store should be. At first everyone was determined to avoid pink—fraught with meaning for a generation of women who saw the start of the feminist movement. But emboldened by the recently launch women's magazine *Pink*—whose slogan "a beautiful career, a beautiful life"—th reclaimed a dusty hue as a statement femininity come of age.

Pressler will be watching closely to se the strategic design lures women aw from stores such as Chico's, Talbots, a Ann Taylor, which all have long-term re tionships with their shoppers. But even Forth & Towne doesn't blossom the w Old Navy did, Pressler says the process h already yielded benefits for Gap Inc. "I not that I think we would do a center ting room for the other brands," Press says, "but the importance of the fitti room as a destination that people rea want to hang out in is certainly somethi we take away." If the ambitious plans ta hold, expect more wienies from Gap. ■

–By Andrew Blum in New York, w Louise Lee in San Mateo, Ca

PLAYBOOK: BEST-PRACTICE IDEAS

Design by David Rockwell

Rockwell values experience over look. Here are some of his guiding principles:

THE DESIGN COMES LAST
His first presentation about Forth & Towne was about the rituals of shopping, not architecture. "It allowed us to evolve a more ambitious plan than if we went right to a design solution."

BE OPEN TO THE EUREKA! MOMENTS
Inspiration comes from unexpected places. With Forth & Towne, for example, the idea of putting the fitting rooms in the center of the store began by trying to design a central chandelier.

FOCUS ON THE UNIQUE
Though Forth & Towne could grow to many locations, Rockwell assumed there would be only one. "If you start out thinking about the replication, you probably never get to the unique thing."

EXPERIENCE OVER AESTHETICS
The spaces Rockwel designs are beautiful, but they're also emotional. "What something looks like comes after a very detailed conversation about ... what it will do," Rockwell says.

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FLYING HIGH Bodenheimer (in photo illustration) now oversees 50 ESPN businesses

he Zone

s rivals circle, ESPN boss George Bodenheimer is trying to push his world-beating brand even deeper into the lives of sports fans

BY TOM LOWRY

PHOTO ILLUSTRATION BY MICHAEL ELINS, USING BODENHEIMER PHOTOGRAPH BY ERICA BERGER

ON SEPT. 19, MILLIONS OF FANS TUNED in to a rare Monday night pro football doubleheader. Interlaced with plays were cutaways to a telethon to help victims of Hurricane Katrina. Viewers of ESPN and ABC saw some of the biggest legends in sports fielding calls from a studio in Manhattan's Times Square: Frank Gifford, Bart Starr, Gale Sayers, John Elway, Eric Dickerson, Donovan McNabb, George Bodenheimer... huh? George Boden-who?

What most folks watching didn't realize was that the stiff-looking guy with the phone in his ear is perhaps the single most influential person in all things sports. As president of the ESPN Networks and ABC Sports, George W. Bodenheimer runs one of the most successful and envied franchises in entertainment, the jewel of Walt Disney Co., and among the most powerful brands of the last quarter-century. While his round-the-clock networks are all about being brash and in-your-face, Bodenheimer is the rare media mogul who is adamant about staying behind the scenes. ESPN's top public-relations executive had to practically drag Bodenheimer out of a production booth and push him in front of the cameras to make an appearance at the Katrina telethon, which he helped pull together with the National Football League in a matter of days. "It's just not about me," he could be heard mumbling as the PR chief made sure his tie was straight.

That modesty has worked well for the 47-year-old Bodenheimer, and ESPN has flourished in his seven years at the helm. Sure, the ESPN he inherited had already extended itself from TV to print, the Internet, and other platforms. And its smart-aleck, testosterone-laden culture was already a trademark. But Bodenheimer's vision of his company, where he started in the mailroom, is as a ubiquitous sports network—and more. To really understand ESPN, you need to see it as a cluster of feisty,

WITH PROGRAMMIN LIKE THE X GAMES, ESPN DRAWS LEGIONS OF YOUNG MALES

creative enterprises under one killer brand. Its units, spread out mostly over offices in Connecticut, New York, and Los Angeles, act like startups, full of passionate staffers who are given the freedom to drive forward but alw with a mission to keep the customers (rabid and tech-savvy f like themselves) happy. Bodenheimer "realizes ESPN has to fast-paced," says Simon Williams, CEO of consultant Sterl Branding. "In his realm, if you stand still you're dead."

So, through 50 different businesses, Bodenheimer pushed ESPN into broadband, on-demand video, wireless, hi definition, even books. His company has the X Games. It burgers and fries at ESPN Zone restaurants. Video games coming soon. All the while, the daily news and highlights sh *SportsCenter*, is as much must-see TV for millions of Americ as the nightly news shows were a generation ago. Put it all gether, and Bodenheimer's competitors can't help but express awe. So ESPN has become a model for a wide range of companies, media and others, struggling to make their

ESPN The Empire

First, a TV channel, and now.....

MORE CHANNELS Nine TV outlets, including ESPN2, ESPN HD, ESPN Deportes, and ESPN Classic.

ORIGINAL PROGRAMMING ESPN develops its own shows and movies, including ESPN2's *ESPN Hollywood*, *Cold Pizza*, and the new *Bound For Glory* high school football reality series featuring Dick Butkus.

RADIO The largest U.S. sports-radio network, with more than 700 affiliate stations, features hit shows *Mike & Mike in The Morning* and *The Dan Patrick Show*.

ONLINE ESPN.com gets more than 16 million unique users a month. Includes ESPN Motion, an online video service, and ESPN360, offered via broadband; Verizon is one carrier.

PUBLISHING The biweekly *ESPN The Magazine* won a National Magazine Award for general excellence in 2003. It launched a China edition (right) in the fall of 2004.

WIRELESS Mobile ESPN is an ESPN-branded phone (left) and customized service that rolls out in February.

GAMING Video game leader Electronic Arts has a 15-year deal to be the sole licensee of the ESPN brand in sports games, which will include console, handheld, PC, and wireless games.

X GAMES Annual extreme sports competition features motocross, bike stunts, and skateboarding.

ESPY AWARDS Athletes and celebs recognize top achievements in sports and to support The V Foundation for Cancer Research founded by ESPN and late college coach Jim Valvano.

ESPN ZONES Eight sports-themed restaurants operate nationally, with a new one set to open in ESPN's planned $100 million studio facility near the Staples Center in Los Angeles.

INTERNATIONAL The world's largest distributor of sports, ESPN makes its programming available in 11 languages in more than 180 countries.

nds work in new markets. "They have always had a halo to things like a *SportsCenter* really well," says Jeff Price, chief keting officer at *Sports Illustrated*. "Nobody has created se touchpoints with consumers like they have." Adds Adam er, the top TV executive at the National Basketball Assn.: orge lets others shine, but don't be fooled by the aw-shucks nner. He's an extremely effective manager who has put his pany at the cutting edge of the digital revolution."

EMEMBER TO HAVE FUN

VER ONE TO GLOAT about the successes, the understated lenheimer confesses that the track he has been pounding is ing a whole lot steeper lately. At his back is a slew of rivals ning momentum. First among them is Comcast Corp., the 1 U.S. cable operator. Looking to build a cable sports net- k to rival ESPN's, Comcast is also ESPN's biggest distrib- r, so its plans could aggravate what's already a delicate re- onship. Right about now, Bodenheimer is placing a hefty on an ESPN-branded cell phone and has said that making new business a winner will be one of his biggest chal- ges of the year. The cell phone is a move into an alluring rket—delivering sports data and images to insatiable fans ll hours. But the payoff is uncertain at best, and the ven- e, announced on Sept. 27, could ultimately dent earnings tarnish the brand. Bodenheimer's angst was turned up a ch or two higher when a key executive, Mark Shapiro, re- ned in August. As head of programming and production, piro was seen as a driven ideas guy who kept new shows ving and viewers tuning in. He was also an effective bad cop to Bodenheimer's good cop at the negotiating table.

Shapiro is often compared with Bodenheimer's high-energy predecessor, Steve Bornstein, ESPN's president during much of the 1990s. The 26-year-old network's initial blast of growth came under Bornstein, whose swagger infused the place with the cocky culture so strong today (page 78). Bodenheimer's core strength, say longtime staffers, has been to preserve and encourage that vibe without making it all about George. His message to the staff is something like: ESPN isn't mine, it's yours, so run with it. And remember to have fun.

Bodenheimer is in Brooks Brothers most days, but his operation is anything but buttoned-down. It's more about hoodies and DC skateboarding shoes, which is to say it's all about being young. When *ESPN The Magazine* launched in 1998, designer F. Darrin Perry gave its pages a bold look with bright colors and unconventional type. That high-octane feel extends even to the magazine's offices in midtown Manhattan, which are designed to look like a gym, complete with an old school scoreboard. On any given day at the main ESPN campus in Bristol, Conn., now encompassing 100 acres dotted with dozens of satellite dishes, you might find former All-Star second baseman and *Baseball Tonight* host Harold Reynolds waiting in line for brick-oven pizza in the fancy staff cafe, or *SportsCenter* anchor Stuart Scott looking for someone to spot him on the bench press in the state-of-the-art gym. A new $160 million digital center and studio, crammed with robotic cameras and lighting rigs, is ringed with flat screen TVs beaming sports in crisp hi-def. A central control room houses producers at computers editing a constant stream of digital-video game feeds.

The whole scene is NASA meets the bleacher creatures. "People have a passion for sports," says Rich Weinstein, the ESPN account director at ad agency Wieden + Kennedy, which has captured the spirit of ESPN through its award-winning spots for the network. "If your job is your passion, it brings a new perspective to the creative process. George was here when this was a startup, and he has preserved that feeling." True to form, at a strategy session this summer for the new phone, the

boss rolled up his sleeves, snapped open a Diet Coke, and burrowed down into every marketing idea the team pitched. Un-mogul-like, he never checked his BlackBerry or cut off discussion. Then he took the group out to a swanky trattoria.

Bodenheimer, who squeezes in a golf game when he can, loves to break the ice by talking about —what else?—sports. He tries to stay engaged with workers across the company without micro-managing. "The great thing about George is that he can stand back and let his managers create," says Gary Hoenig, editor-in-chief of *ESPN The Magazine*. Going up against venerable *Sports Illustrated*, ESPN's seven-year-old biweekly has made great strides. Since 1999, circulation has grown by about 1 million, to 1.8 million, while *SI* has held steady at 3.3 million, according to the Audit Bureau of Circulations. Hoenig also credits Bodenheimer with granting him the freedom to develop lucrative specialty newsstand magazines like one on fantasy football.

Tanya Van Court, whom Bodenheimer hired from Cablevision in April, 2004, to oversee a revamp of broadband service, insists, too, that the boss never meddles. During the eight months that the new product ESPN360 was in development, "he would send hand-written notes with suggestions every week and a half or so," she says. "He would offer up [notes like], 'make it the ultimate on-demand product for the sports fan and one that is as flexible as possible.'" When ESPN360 launched last January with programming tailored for broadband—including short clips recapping Sunday games—it just may have hit on a new model (page 74). ESPN insiders liken it to cable TV in its infancy in the 1970s. So far, ESPN360 is available to nearly 5 million users through 14 different broadband providers.

Branding, By George

George Bodenheimer oversees one of the great brands not only in sports but in all of Corporate America. Here are his tips for nurturing a top brand:

1 DEFINE YOUR MISSION "Serve the fans. That's why we are launching our new cell phone and service, to be able to reach fans wherever they are."

2 KNOW WHAT YOUR BRAND IS "We view ourselves as the world's biggest sports fan. Be fun. That's why we try to keep our programming lively without taking ourselves too seriously."

3 CULTIVATE RELATIONSHIPS WITH YOUR CUSTOMERS "Talk to fans, not at them. We try to do that with our award-winning ad campaigns."

4 DEVELOP AN INCLUSIVE CULTURE "I came up from the mailroom, so I had managers who were listening to me. You need to let everyone contribute."

5 CONTINUALLY ENHANCE YOUR PRODUCT "We have launched three new channels in the past two years, a broadband service, and a cell-phone service. And we are always tweaking our franchise show, *SportsCenter*. We've added more music and highlights recently."

IRRESISTIBLE ECONOMICS

CAN BODENHEIMER THE DELEGATOR and his decentralized, free-thinking culture keep up the winning streak? "The next two years will be a real big test for George," says Sean McManus, head of competing CBS Sports and a friend of Bodenheimer's. All around it, companies are imitating ESPN's cool and edgy packaging of sports. And if live sports is the last great mass market to lure advertisers, then how long can ESPN expect to dominate? Throw in a sports-crazed, often-elusive audience of young men bordering on the fanatic, and the economics are irresistible. That's why so many players are pushing into Bodenheimer's domain, from teams and leagues launching their own channels to cable and satellite operators creating new offerings. "ESPN listens to its audience very closely," says Sterling's Williams. "If it keeps doing that, [that] should be the glue that holds it together."

Even so, the ESPN chief the days finds himself playing more d fense than offense to keep gam out of competitors' hands. One si of the times: big hikes in the pric ESPN is paying to lock up new p football and Major League Baseb rights contracts. The $2.4 billio eight-year MLB deal announced Sept. 14 represents a 50% annual i crease in fees. And in April, ESI ponied up $8.8 billion for a n eight-year *Monday Night Footb* deal with the NFL for only one nig of football. ABC will no long broadcast games, including the l crative Super Bowl; NBC grabb ESPN's old Sunday night spot. T bottom line: ESPN will pay nea twice as much a year than it did la time around, though other goodi were included, such as wirele rights that will allow ESPN for t first time to deliver Monday nig highlights to cell phones. "You ha to ask yourself how much grow will be left if they keep spending li this," says Richard Greenfield, analyst at Fulcrum Global Partne LLC. Counters Bodenheime "Look, we are a sports-media co pany, and we program sports. I like saying a seafood restaurant being defensive when it reorde lobsters."

Bodenheimer, of course, lives i world that's not totally of his ow making. His ESPN is part of a ten pest-rocked ship known as Disne For years, ESPN has been able to its own thing for one reason: It was the outfit former CE Michael D. Eisner could count on for the numbers. Now, wi Eisner gone, Bodenheimer will work closely with an old frien new CEO Robert A. Iger, a onetime exec at ABC Sports. T bond between Bodenheimer and Iger is strong, one pro leag executive suggests, because they see themselves in each ot er—"two executives who have always been underestimated Says Iger: "People sometimes mistake being polite for bei easy. That's not the case with George. He's a man of great i tegrity, but he can be tough." Some speculate that Iger mig bring Bodenheimer to Burbank, but for now he needs h friend to stay put, keeping ESPN the financial bulwark it is counterbalance the fickle businesses of theme parks and hi driven TV and movies.

Indeed, ESPN revenues alone this year could be about $5 bi lion, with operating earnings of nearly $2 billion, according projections from various analysts. The revenues—about 60 from distribution fees and 40% from advertising—would repr sent about 15% of Disney's total. Analysts estimate that revenu could grow to nearly $6.8 billion in 2008. More importan ESPN is so central to cable menus that it gives Disney bargai ing power with distributors to pick up other Disney channels, h they SOAPnet or the ABC Family Channel. Emblematic

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ESPN's clout, its longtime head of affiliate sales, Sean R.H. Bratches, was promoted a year ago to oversee distribution for all of Disney's cable channels and broadband services. Using ESPN's leverage was a favorite tactic of Eisner's. So precious was ESPN to the Mouse House that the former CEO told investors several years ago: "We bought the ABC media network and ESPN for $19 billion in 1995. ESPN is worth substantially more than we paid for the entire acquisition."

MUSCLES FLEXED

IT'S ALL THE MORE remarkable, then, that ESPN was created with such modest intentions. It was founded in 1979 by former Hartford Whalers play-by-play man Bill Rasmussen on a patch of mud in the blue-collar central Connecticut town of Bristol by putting $9,000 on several credit cards. Rasmussen started the Entertainment and Sports Programming Network (ESPN) as a way to beam University of Connecticut Huskies games to a larger audience using satellite dishes. But it soon became clear to Rasmussen and his son, Scott, that they were on to something with national potential. Getty Oil would kick in $100 million a year after Rasmussen put on the first shows. Five years later, ABC bought out Getty's position (then owned by Texaco Inc.) and in 1988, Hearst Corp. bought a 20% position that was held at the time by RJR Nabisco.

Hearst still has a 20% stake, but Disney is the active manag "Nobody could have anticipated how much of a financial ju gernaut ESPN would become," says Fulcrum analyst Greenfie

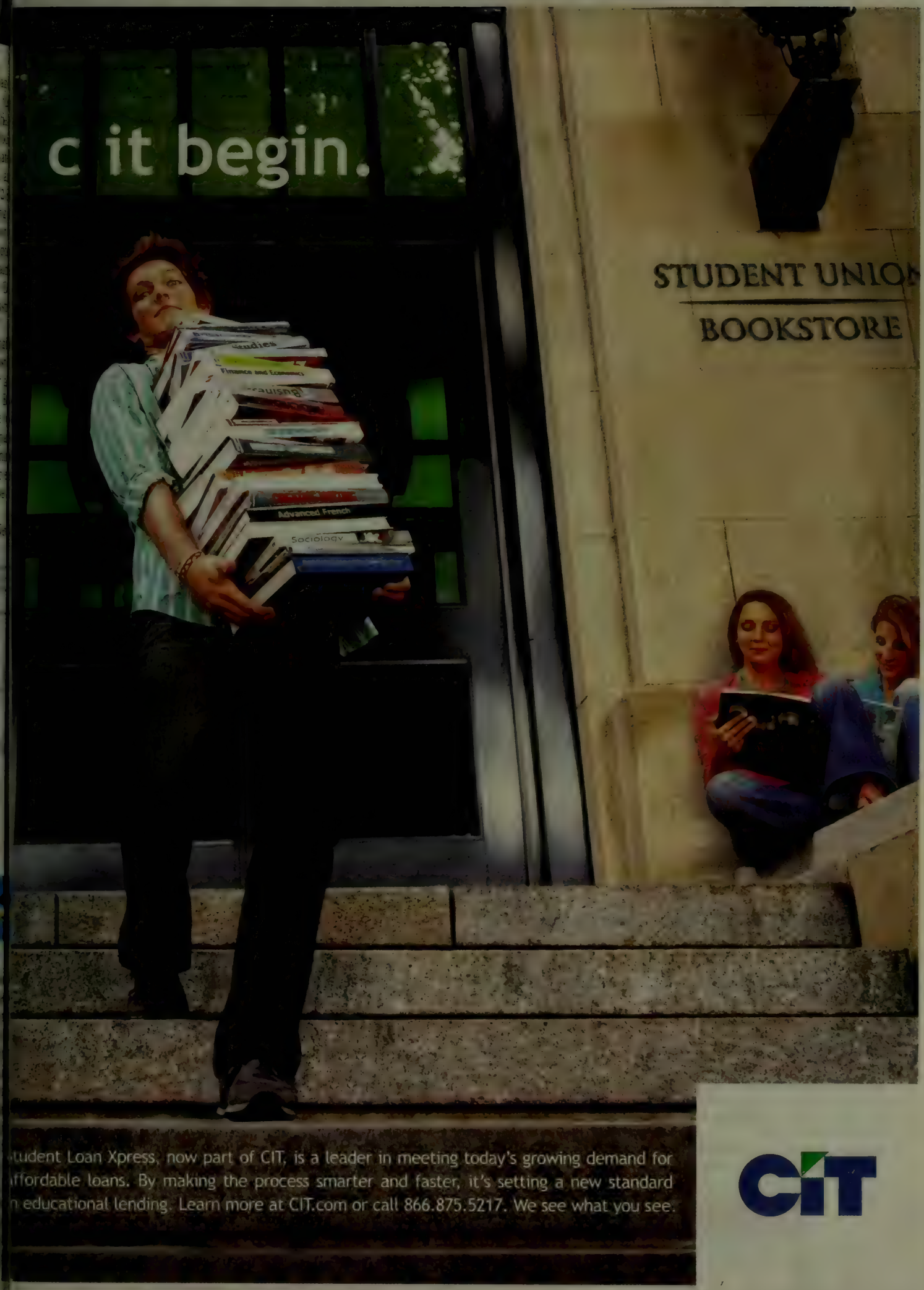
Over the years, ESPN began to flex its muscles like the joc it had helped turn into celebrities. It charged its cable and sat lite distributors nearly twice as much for its service than a other channel fetches. (Today, ESPN gets an estimated $2. per subscriber per month, vs. about 40¢ for CNN, according Morgan Stanley). Double-digit hikes each year created a lot ill will, culminating in a showdown two years ago that erupt in the halls of Congress. The battle pitted Bodenheimer agair James O. Robbins, the outspoken CEO of cable operator C Communications Inc., who, acting on behalf of his indust complained to lawmakers about the steep fees.

The brawl put Bodenheimer in an unwelcome spotligh where he defended ESPN's pricing by blaming the high cost rights deals with the leagues. Eventually Cox won lower a nual fee increases, down from about 20% to about 7%. B ESPN claimed victory, too: New agreements included the o erators' carriage of the latest ESPN channels, such as its Spa ish-language outlet ESPN Deportes. "We achieved everythi we wanted in that negotiation," says Ed Durso, ESPN's top e ecutive for government and public affairs. "George rose the occasion."

Bodenheimer knows the next battle is the big one. Ne

TO KEEP PRO GAME ON ITS CHANNELS— AND AWAY FROM RIVALS'—ESPN MU NOW **DIG DEEPER** FOR BROADCASTIN RIGHTS

Corp. founder Rupert Murdoch, with 15 regional sports channels, is only making noises about a national spor channel. Comcast is making plans. It has held several mee ings in recent weeks to talk strategy and has even contacte ESPN executives about jumping ship, say sources close both companies. Comcast already owns the Philadelph 76ers, the Philadelphia Flyers, and a bunch of regional spor networks in cities from Philadelphia to Chicago to San Fra cisco. And it's no secret that Comcast CEO Brian L. Rober and President Stephen B. Burke, a former Disney executiv want a piece of the ESPN business model. When th Philadelphia-based cable operator made i unsolicited $54 billion bid f Disney in February, 200 it was driven in part by desire to capture ESPN. Having its own h



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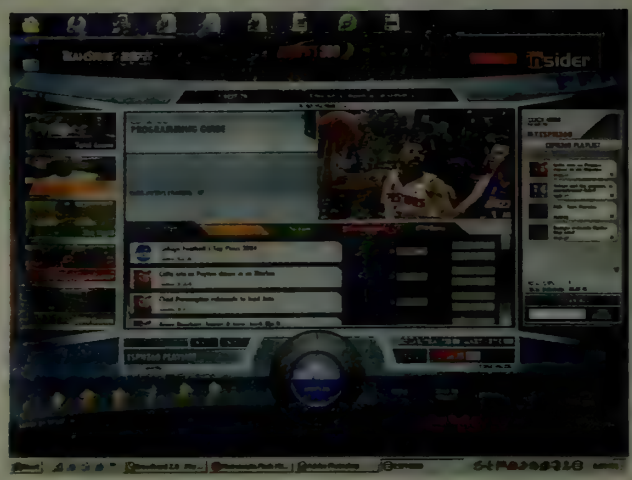
ESPN.COM: GUYS AND DOLLARS

The ESPN cable channel, seen in 90 million households, is a must-stop for any channel surfer. But espn.com is the real boys' club. Young men don't show up *en masse* to anything very often, but where they do, advertisers will spend. That's what makes espn.com, with its devoted audience of guys 18 to 34, a coveted spot.

But luring Web users with hot commentators (*Sports Guy* columnist Bill Simmons), cool streaming video (ESPN Motion), the latest scores, and top-notch fantasy-league services, ESPN can use in-house promos to send them back out to its other platforms. "We look at our Web site as being like a bazaar with something always going on," says John Kosner, a senior vice-president.



SPORTS ON THE NET The site is tops for males 18 to 34

The 10-year-old site is the biggest Internet draw for sports. In August, espn.com had 16.6 million unique visitors, says ComScore Media Metrix. That's far more than its closest rivals, Fox Sports on MSN (with 12.6 million uniques), nfl.com (12.6 million), and Yahoo! Sports (12.3 million). SI.com, the Web site of ESPN's magazine rival *Sports Illustrated*, trails at 5 million. The median age of an espn.com is 32 vs. 38 for Net users in general.

ESPN doesn't disclose revenues, but Kosner says t Web site makes most of its money from ads. "It offers big three," says Tim Hanlor senior vice-president at me buyer Starcom MediaVest. "Young guys. Sports. And a powerhouse media brand. That's just a home run for advertisers." Subscription revenues at espn.com are growing, too, through its $6 a-month Insider and with fantasy services. Broadban rise will accelerate offering And espn360, a customizat high-speed service, showcases super-sha video and behind-the-scenes coverage. A rivals, such as a revamped CBS SportsLin ESPN's Kosner says: Bring it on. "I'd rathe where we are sitting." No kidding.

–By Tom Lowry in New

sports channel would give Comcast ESPN-like leverage, amplifying its powerful 22 million subscriber base—even if its expertise is largely that of a distributor, not a programmer. For now, it's sticking to plans to convert its relatively unknown Outdoor Life Network, available in 64 million homes, into an ESPN for the new millennium. OLN got some buzz by airing Lance Armstrong's cycling feats every summer from the Tour de France. The rest of the channel's programming, from bull-riding to fishing shows, has niche appeal at best.

But Comcast is moving fast. It signed a $300 million, five-year deal in August to broadcast National Hockey League games on OLN starting this fall, with an option to bail out after two years. (ESPN ditched the sport after its contract expired this year following the acrimonious lockout.) Now, Comcast needs to cinch some of the remaining 60 games available from MLB and win a package of Thursday and Saturday games from NFL, which draws the largest TV audiences in sports. "With the NFL, I don't see anybody being a threat to ESPN," says J Mansell, a senior analyst at Kagan Research LLC.

Inside One of the Biggest Baseball Deals Ever

Grand Slam: A behind-the-scenes account of ESPN's latest big deal, its eight-year, $2.4 billion deal with Major League Baseball

Making a Mark: ESPN's outgoing programming chief, Mark Shapiro, talks about leaving "one of the best jobs in America," his next venture, and why ESPN said no to the NHL

Entertainment, Sports...Journalism? A look at journalism as practiced by ESPN—and at the sports network's new ombudsman, George Solomon, who's cheering and jeering from the sidelines

Not Just an American Play: From the wrestling rings of India to the skateboarding competitions of South Korea, ESPN is forging an Asian strategy to capture a piece of the region's fast-growing advertising market

Get the story on the Cover Story: For a podcast interview with Senior Writer Tom Lowry by Executive Editor John A. Byrne, go to businessweek.com/search/podcasting.htm

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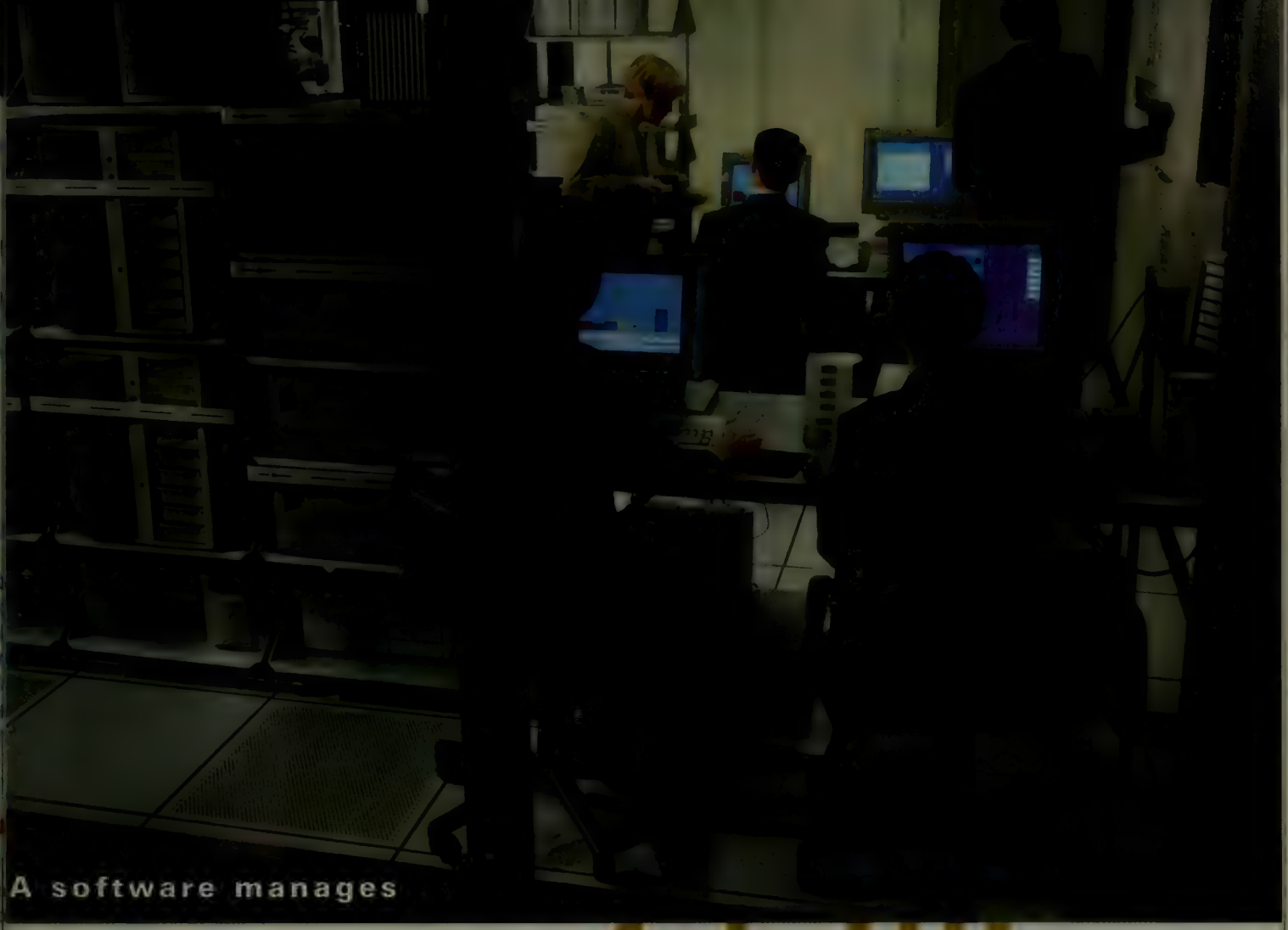
GAMES IN YOUR POCKET

EVEN AS HE FENDS OFF RIVALS, Bodenheimer is about to l his troops into ESPN's trickiest brand extension so far. The i is that ESPN could be missing the chance to stay in touch v fans who get off the sofa or walk away from their compu screens. Says Bodenheimer: "We want fans to know you d have to let the rest of your life get in the way of being a sp fan. You can take it with you." In the past year he has met quently with the Mobile ESPN development team to sign of everything from the phone's black-and-red design on a Sa handset to the special displays constructed for big retail ESPN is leasing network time from Sprint Nextel Corp. and outsource billing, messaging, and customer service (its pric yet to be announced). The opportunity to partner with ES was a no-brainer for Sprint Nextel CEO Gary Forsee. "As pr as we are of our brand, we'd be hard pressed to say Sprint successfully go after the segments that ESPN [does]," he s "But ESPN is the world leader, right?"

Still, the risk for ESPN is that if the phone bugs out, us won't be cursing some wireless outfit—they'll be blami ESPN. "Content providers need to focus on what they best," says one TV executive. "Hardware plays are frau with problems." And the venture will require patien "Sometimes it is up to two years with this kind of busin before you reach enough scale with subscribers to be able turn a profit," says Marina Amoroso, a wireless anal with researcher Yankee Group. Bodenheimer says he's aw of the perils, "but it is a riskier move not to do thi

The last thing Bodenheimer needs now is to worry about talent. Yet shortly before programming whiz Shapiro quit, Ch



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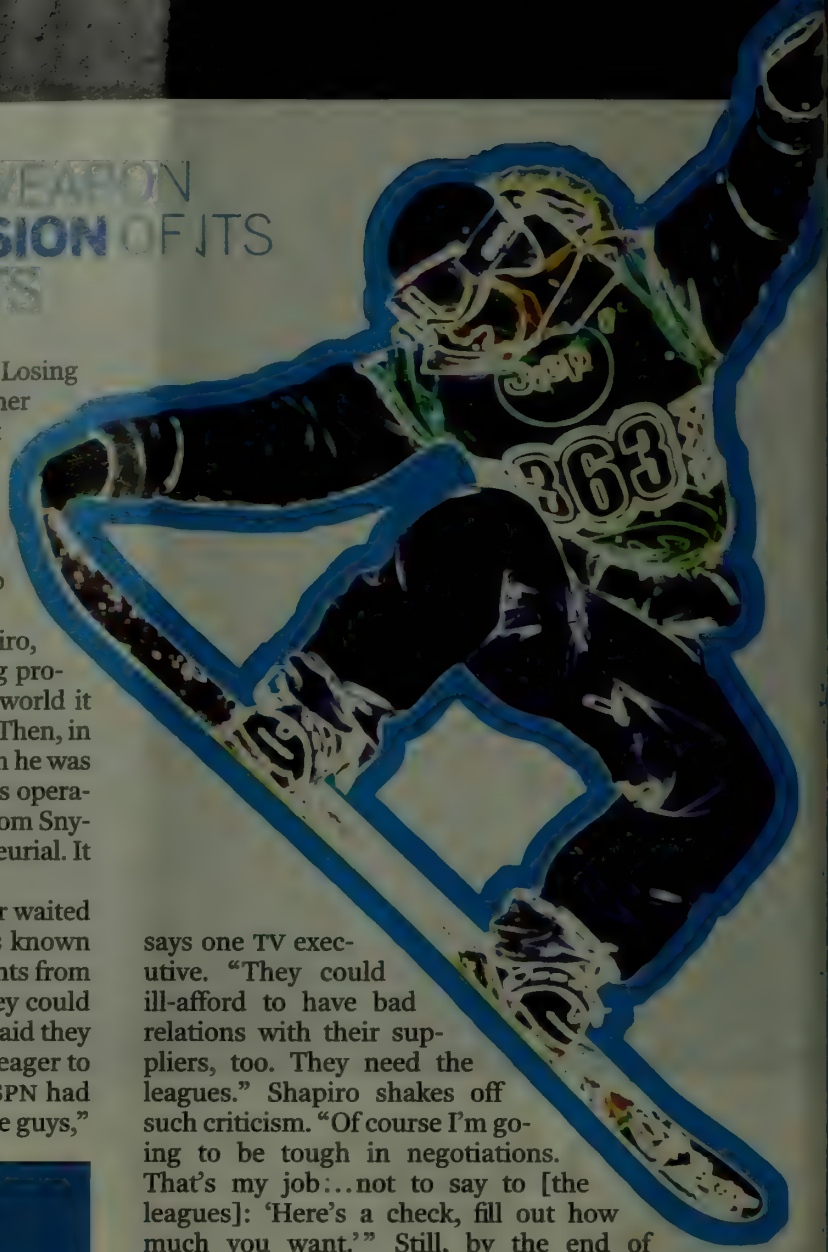
ESPN'S SECRET WEAPON MAY BE **THE PASSION** OF ITS STAFF FOR SPORTS

Marketing Executive Lee Ann Daly resigned as well. Losing Shapiro, who quit to join Washington Redskins owner Dan Snyder in remaking Six Flags Inc., is the most problematic. Shapiro's handiwork is all over the network. ESPN Original Entertainment, the cable network's venture into movies, episodic dramas, and talk shows, was his creation. He gave juice to *Sports Century*, the Emmy Award-winning series of profiles of top athletes (and a horse, Secretariat).

In June, Disney heaped new responsibility on Shapiro, promoting him to executive vice-president, overseeing programming at both ESPN and ABC Sports. To all the world it looked as if his next step would be into headquarters. Then, in early August, Shapiro met with Bodenheimer to tell him he was thinking about leaving. He'd had a feeler to head news operations at NBC. A few weeks later he accepted the offer from Snyder. "I knew at some point I was going to go entrepreneurial. It was just a question of when," says Shapiro.

Questions remain about why Bodenheimer and Iger waited so long to lock Shapiro into a new contract. But it is known that top executives at ESPN had been fielding complaints from the brass at pro sports leagues for some time that they could no longer work with Shapiro. Several league officials said they had never dealt with a negotiator as aggressive or as eager to pass himself off as the smartest guy at the table. "ESPN had just had tough relations with their customers, the cable guys," says one TV executive. "They could ill-afford to have bad relations with their suppliers, too. They need the leagues." Shapiro shakes off such criticism. "Of course I'm going to be tough in negotiations. That's my job:..not to say to [the leagues]: 'Here's a check, fill out how much you want.'" Still, by the end of Shapiro's tenure at ESPN, officials in at least two leagues refused to deal with him unless Bodenheimer was on the talks.



George Ward Bodenheimer

TITLE President, ESPN/ABC Sports; co-chair, Disney Media Networks.

BORN May 6, 1958, Meriden, Conn.

EDUCATION BA in economics, Denison University.

FAMILY Wife, Ann, an events planner; children Kate, 18, George Jr., 16; and James, 14.

FIRST JOB Pumping gas at a Hess station.

FIRST JOB AT ESPN Started in 1981 in the mailroom and used to drive on-air talent like Dick Vitale and Greg Gumbel back and forth from the airport in Hartford to ESPN studios in Bristol, Conn.

HOBBIES Golf (handicap: 21) and shallow water "flats" fishing in the Florida Keys. Caught a 6-foot tarpon once.

LAST BOOK READ *Striper Chronicles* by Leo N. Orsi Jr.

FAVORITE MUSICIANS Bruce Springsteen and the Rolling Stones.

HEROES Mother and father. She was a homemaker and bank teller. He was the manager of a department store in the Howland-Steinbach

"MINUTE-TO-MINUTE BATTLE"

SHAPIRO MAY HAVE ALSO TICKED OFF Disney top brass wh he turned down an offer last year to become president of A Entertainment, the No. 2 job under then-ABC executive Sus Lyne, who would have become chairman, say sources wit the company. The plan was to eventually move out Lyne a put Shapiro in charge, those sources say. Shapiro told Iger was excited about running prime time—but ultimately turn him down flat. Bodenheimer denies that there was any ill w toward Shapiro at Disney.

Bodenheimer says he is confident that the culture he h fostered, one of tapping ESPN's inner strengths, will ul mately make Shapiro's departure less of a blow. "Mark w obviously a significant contributor," says Bodenheimer. "H a great talent, but we have a tremendous reservoir of tal here." In fact, Bodenheimer used Shapiro's departure to align top management in early October into new segmen content, technology, sales and affiliates, and internatior John Skipper, the much-admired senior executive w oversaw advertising and new media, will now run conte assuming much of Shapiro's programming mantle.

How Bodenheimer leads will go a long way in determini

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whether ESPN remains preeminent, especially as competitors zoom in on niches like volleyball, tennis, you name it. "ESPN will always be a general store of sports," says Brian Bedol, co-founder of college sports channel CSTV, "but it may have to learn to coexist with the leagues and new media companies [that] want to reach fans with very special interests. Technology today is allowing for a direct relationship with those fans."

Nobody wants to understand fans more than Bodenheimer, who will often leave the luxury boxes at games and w through arenas studying the crowds—unrecognized, course. "It's a minute-to-minute battle to retain viewers in day's media world," says Bodenheimer. "That's why I wan know what fans are saying—about sports, about ESPN." also why the most powerful man in sports needs to stay at top of his game. ■

–With Mark Hyman in New Y
Ronald Grover in Los Angeles, and Roger Crockett in Chic

MR. TOUCHDOWN FOR NFL TV DEALS

If you want to beat the other team, what better way than to put someone in charge who knows their plays? No surprise, then, that when National Football League Commissioner Paul Tagliabue was looking for an executive to renegotiate the league's TV contracts and expand its media presence, he drafted former ESPN President Steve Bornstein.

A 22-year veteran of ESPN and ABC, Bornstein knew every network exec's head fakes and stutter steps. The payoff has been tremendous for the NFL at the bargaining table as well as with the launch of its own cable channel, the NFL Network. Since his arrival at the league in late 2002, Bornstein, 53, has negotiated $24 billion worth of new rights contracts—resulting in a 53% hike over earlier deals. "He's a great auctioneer," says Stephen B. Burke, president of cable operator Comcast. "The NFL has tremendous value. He gives it more."

BORNSTEIN His years at ESPN taught him how to play networks off one another

The Bornstein process isn't always pretty. To be sure, the tough-talking New Jersey native who learned to use sharp elbows to get his shot as a sports cameraman while at the University of Wisconsin, plays hard. He dangles games before competitors and applies pressure like a blitzing strong safety.

Both CBS and Fox agreed to hefty increases last year after Bornstein began talking to NBC, which had dropped broadcasting football but got back in this spring. And heading into talks with his old employer, he knew how much ESPN needed football. If it lost the NFL, the network would have had to pay a 35¢ monthly fee per subscriber back to cable operators, or about $370 million annually. The result: ESPN offered $8.8 billion for a new Monday night package.

What's more, Bornstein is building up the potential competition against his successor, ESPN President George Bodenheimer. He oversees the NFL Network, a cable channel the league launched two years ago. It is seen in 35 million homes, which is still less than half of all cable and satellite households. "He brought a perspective we didn't have," says NFL Executive Vice-Presid Roger Goodell. The NFL's channel doesn't air regular season games yet, but its shows, like *NFL Total Access*, have that ESPN feel.

What's more, the NFL Network is a strategic asset. The NFL can simply threate to put its own games on its own channel if i not getting high enough offers from others. also a great way to boost distribution. Satel operator DirecTV Group, for instance, agre to distribute the channel to help it negotiate its new $700 million-a-ye deal for the Sunday Ticket telecasts.

Bornstein, who lives in the former Fred Astaire mansion in Beverly Hills, shuttles betwe the NFL's West Coast offices and its Park Avenue digs in Ne York. "He's still g the entrepreneu spirit that ESPN had in the '80s a '90s," says NASCAR Vice-President Dick Glover, who worked with Bornstein in the 1990s. Bornstei earned a reputati as a no-nonsense taskmaster who would shoot down underlings by pointing to a "bull-****" meter on a blackboard.

His ability to make ESPN into a money spinner earned Bornstein a ticket upward a parent Walt Disney Co., but his thankless ta was to turn around ABC and jump-start Disney's woeful Go.net. "I told him not to ta the Internet job, but he really didn't have a choice," says former Cap Cities Chairman Thomas S. Murphy, a Disney board membe "Michael [Eisner] wanted him to do it." But after CEO Eisner picked Robert A. Iger as Disney president, Bornstein resigned.

Within months he had joined the NFL. "It was fun getting back to my roots, starting a cable channel," says Bornstein. Spoken like guy who's back in the lineup.

–By Ronald Grover in Los Ang

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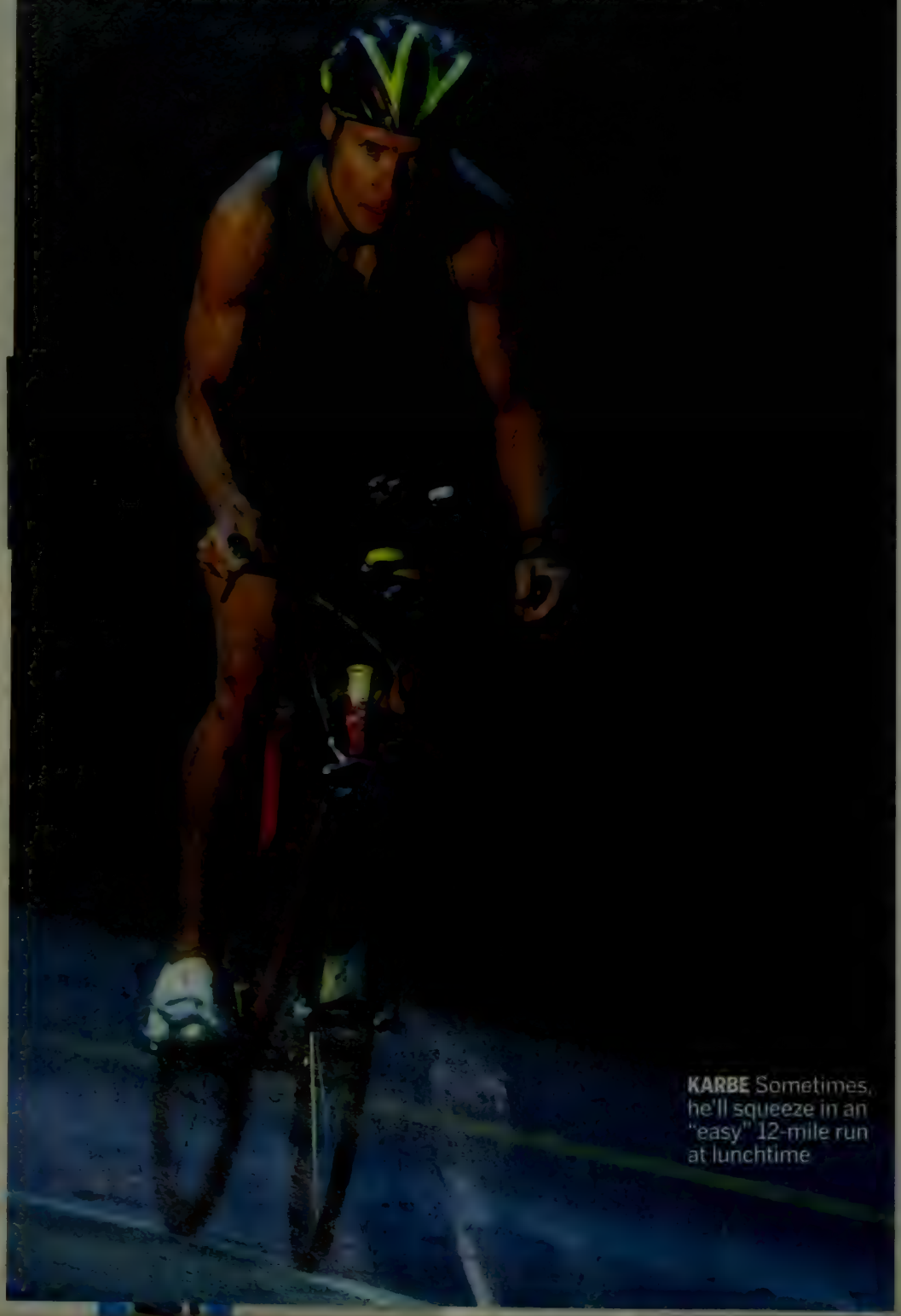
And Now, the Chief Endurance Officer

More execs are shunning the golf course for triathlons and adventure races



KARBE Sometimes, he'll squeeze in an "easy" 12-mile run at lunchtime

FRANK KARBE, CHI nancial officer of San cisco biotech outfit F Inc., has been spinni wheels for more th hour and getting now must be 100 degrees room jammed with 13 other peo sweating, all staring at the wall.

Fortunately, this isn't a presenta a nervous bevy of investors but minute heat-adaptation cycling cla the second of three workouts Kar has scheduled for the day. During he squeezed in an "easy" 12-mile r ter a business dinner, at a restaur chose for its proximity to The S Club/LA in downtown San Fran he'll swim 3,500 yards—that's just two miles—while most people are raiding the fridge before bed.

"Sometimes I'm out there trainir til midnight," says Karbe, who qu for the Ford Ironman Triathlon Championships on the Big Isla Hawaii on Oct. 15 by finishing hi Ironman, in Coeur d'Alene, Idaho one of the fastest times in his age g He swam 2.4 miles, biked 112 mile ran 26.2 miles in a swift 9 hours a minutes. "I'm pretty ambitious," he with no shortage of understatemen

Karbe is not alone. He'll be in the pany of about 1,800 athletic overac ers at the championships, among th high-level executives whose pa Hawaii began by signing up with Challenge LLC in Boulder, Colo. Gro numbers of businesspeople like Kar defying the stereotype of the well-pa executive whose idea of exercise is a around the links followed by a muc served stop at the 19th hole. Ins they're vying for a new title—"chie durance officer"—by rising at 4 a.m pursuing brutal training schedules juggling family and corporate duties

Not all extreme execs are into Iron events. Kevin Mahaney, the 43-yea CEO of real estate developer Olympia in Portland, Me., captured an Olympi ver medal in sailing in 1992, skippere America's Cup syndicate in 1994, won a national age-group snowboar championship in 2004. This July, jus fun, he rode all 2,241 miles of the Tou France in 21 days, keeping a day ahea the actual race, in a custom trip pu gether by Destination Cycling in Ma head, Mass.—and he's planning to d same thing next year.

Or take Seagate Technology William D. Watkins. He started d "adventure races" six years ago and

RAHAL Intense training is a natural outgrowth of professional hard work, says the Washington lawyer

e completed several 24-hour and two ti-day events. Such races, typically re- ring teams of three or four to navigate icult terrain via mountain bike, kayak, foot, "force people to take a hard look hemselves in an environment out of r comfort zone," says Watkins.

ut the largest group of would-be chief urance officers seems to aim at hlons. This year, 45 executives signed vith CEO Challenge. To do so, an exec st have the rank of chief financial offi- or above in a company with $5 million sales (for men) or $2.5 million (for nen)—the lower number for women is ttempt to induce more of them to en- For $6,250, the exec buys entry into of three Ironman events. The fee in- les meals, accommodations, custom suits, and the chance to rub well-de- d shoulders with the top professionals he sport, such as Chris Legh or Kate or. Execs who qualify for Hawaii get passes and have the option to pay an itional $1,400 for other perks.

T YOUR PEERS

S YEAR, SIX of the CEO llenge entrants, including be, made the champi- hips by posting fast- ugh times in a preliminary man to qualify under the eral rules; the other 12 le it by beating their CEO llenge peers, thus win- g one of the special slots al- ted to the company. ong the competitors are r Lazar, CEO of Bank Aus- Creditanstalt Financial vices; Alex May, a manag- director at Citigroup; and Ted Philip, former president of Lycos and now head of consulting firm Decision Matrix Group Inc.

So how do typically overworked CEOs find time to train for one of the most demanding sporting tests on the planet when most Americans struggle to get to the gym a couple times a week? Basically, by focusing the same energies on athletics that they pour into their profession. "Ironman training and racing is how I approach life: Set high standards and work extraordinarily hard," says Linda A. Rahal, 41, president and COO of Washington (D.C.) law firm Trow & Rahal. She started training for her first marathon while studying for the bar and plans to finish her fifth Ironman in Hawaii. Observes Ted Kennedy, a former marketing manager with Ironman North America who started CEO Challenge five years ago: "A lot of these people have achieved everything they've ever tried. They love challenges."

That includes the challenge of time management. Erik Blachford, 38, former CEO of online travel giant Expedia.com, did his first Ironman in 2003 and is competing in Hawaii with a slot he bid on and won on eBay. While at Expedia—he left in December of last year—Blachford ran or swam first thing in the morning, then commuted to work via bike. "I knocked off an awful lot of miles just biking the 16.7 miles to and from work, with extra loops if I had time," says Blachford, who now sits on four boards, including that of bike tour operator Butterfield & Robinson.

Although he managed to fit training into his tight schedule, Blachford says he wouldn't do an Ironman again while holding a CEO position because "the demands of the job and training end up taking away from the rest of your life, such as family and social activities." Blachford's wife, Maryam Mohit, found her own ironic way of making peace with it: "When your kids are sick and your husband is pulling out on his bike for a long ride, you just have to tell yourself that as midlife crises go, it beats the alternatives."

Is it fun? Only when crossing the finish line

Mike Dannelly, CEO of Costa Mesa (Calif.) online

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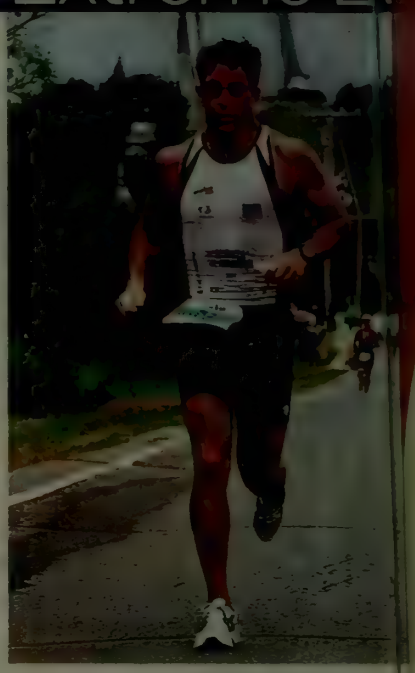
mortgage banker American Interbanc Mortgage LLC, and a sponsor of three pro triathletes, is unusual in this group: Many weeks he trains less than 10 hours. Dannelly, 47, took up triathlons in 1985 after a cocaine-induced heart attack ("It was a low point in my life," he says) and has since done more than a dozen Ironman distance events. "Last week a buddy of mine and I ran up Mount Whitney and back in seven hours and three minutes," says Dannelly, speaking of the 14,491-foot peak in California. "This is the kind of thing that excites me. But the word 'fun' is not applicable, except when you're crossing the finish line."



MAGUIRE A veteran of five Ironman events, he has seven staffers joining him in Florida in November

The notion of top managers moonlighting as endurance athletes might not thrill some shareholders, but these endorphin junkies make a compelling case for their training and racing. Olympia Cos.' Mahaney logs 20 hours some weeks and considers his bike a much-needed office away from the office. At work, "people are banging down your door," he says. "When I'm on the bike I can think of new business ideas. No distractions. No phones. I bring my cell, but only in case I get a flat I can't fix." John G. Macfarlane, 51, COO of Greenwich (Conn.) asset management firm Tudor Investment Corp., completed his third Ironman this summer and cites another benefit of training: It helps ward off insomnia. "One to two hours of exercise a day often cuts into sleep time, but when your head hits the pillow, there's no tossing and turning," he says.

HEART RATE

ALTHOUGH EXELIXIS' Karbe trains an average of 15 hours a week, his strategy is to focus on quality rather than quantity. Every few months he goes to Endurance Mill Valley, a sports lab in his Bay Area hometown, to test his oxygen consumption, power output, and heart rate—and adjust his workout. "The key question we are trying to answer is how much power can I generate over a 112-mile bike ride and still be able to run a marathon in under 3½ hours," says Karbe.

Some executives even link their extreme athletics to achieving social or corporate goals. James Maguire Jr., CEO of Philadelphia Insurance Cos., and seven of his company's staffers will compete at the Florida Ironman in November. Besides crossing the finish line, they plan to raise money for Hurricane Katrina victims by collecting pledges of $10 per mile—i set a *Guinness Book of World Recor* for the most company employee peting in an Ironman distance eve

"I was the instigator," says M 45, who has finished five Ironman since taking up the sport a deca He inspired other officers to follow footsteps and hopes that the fitne ture will catch on with the rest of hi employees. Besides reimbursing th gym membership and giving th longer lunch hour if they work o company sponsors several races, i ing the Ironman World Champion

At Seagate, Bill Watkins sends 2 his 40,000 workers to the annual Seagate," where they learn adventu ing skills and compete in one-day "It helps break down barriers, te people how to take a risk and ask fo and it promotes teamwork," he say

Ex-Expedia CEO Blachford argue endurance training can change s thing more intangible but even mor portant than physical health: a whole approach to business. "In a where you expect immediate result everything you do, it's very satisfyi slowly but surely put time in and bui to do something you couldn't d months before," he says. "That's a le you lose track of in business, espe when throttled on quarterly resu Now he just has to avoid getting obse with beating every other executive tri lete in the world. ■

–By Sarah Max in Bend,

BusinessWeek online For a slide show of BusinessWeek Online's fittest CEOs, go to http://images.businessweek.com/ss/05/fittestceos/index_01.htm

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A Tense Kodak Moment

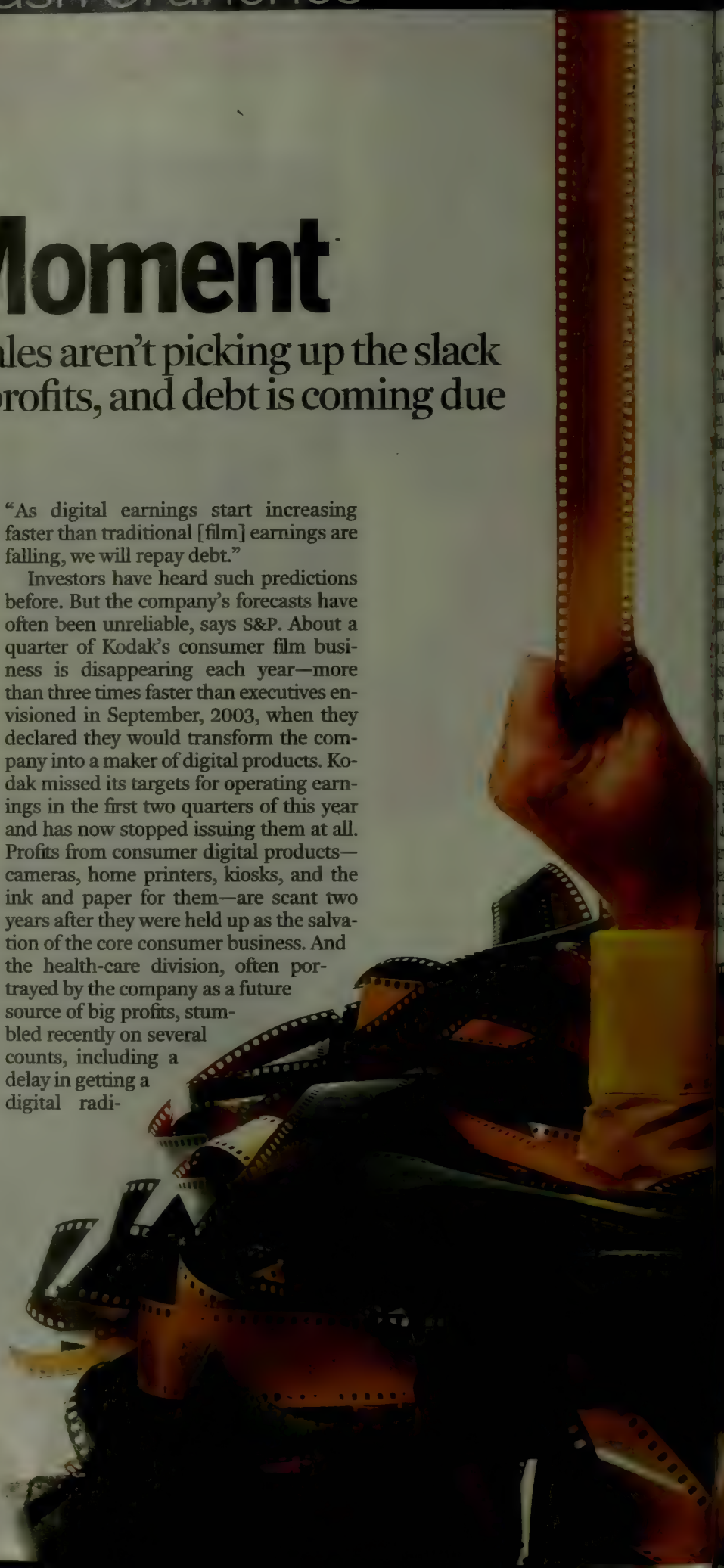
Low-margin digital sales aren't picking up the slack of disappearing film profits, and debt is coming due

EASTMAN KODAK SELLS 22% of the digital cameras in the U.S. annually, making it the biggest player. Its 65,000 yellow, blue, and red printing kiosks seem to be everywhere. And on Sept. 27 the 125-year-old company shipped what it says is the world's first Wi-Fi pocket camera, which lets consumers send good-quality photos directly to the Internet. So you might imagine that the Rochester (N.Y.) company has made a seamless transition to the digital age from the messy analog world of film and chemicals.

Kodak's financial reports show a much darker picture. The company is barely breaking even on its digital cameras. It is scrambling to drum up enough cash both to shut down most of its film and paper capacity—at an estimated cost of nearly $1 billion over this year and next—and to repay $750 million of debt that comes due next year. Its credit ratings, which fell below investment grade in April, were marked down again on Sept. 30 by Standard & Poor's even as it is finalizing a $2.7 billion loan facility.

Senior executives at Kodak concede that the company's balance sheet is "stressed." But they say Kodak will turn up from this financial low point in its massive transformation to digital. By the end of 2006, according to Chief Executive Antonio Perez's plan, the total $1.5 billion cash cost of laying off workers and shutting down factories will be pretty much paid. Besides, no significant amount of Kodak's remaining $2.7 billion of debt is scheduled for repayment until 2010. Chief Financial Officer Robert H. Brust says earnings will start to turn up sometime next year. "We're at a difficult point, but coming along pretty good," he adds. "As digital earnings start increasing faster than traditional [film] earnings are falling, we will repay debt."

Investors have heard such predictions before. But the company's forecasts have often been unreliable, says S&P. About a quarter of Kodak's consumer film business is disappearing each year—more than three times faster than executives envisioned in September, 2003, when they declared they would transform the company into a maker of digital products. Kodak missed its targets for operating earnings in the first two quarters of this year and has now stopped issuing them at all. Profits from consumer digital products—cameras, home printers, kiosks, and the ink and paper for them—are scant two years after they were held up as the salvation of the core consumer business. And the health-care division, often portrayed by the company as a future source of big profits, stumbled recently on several counts, including a delay in getting a digital radi-



phy product to market and the slow llation of software being sold to hos- s. Executives warned on Sept. 28 that ak will fall short—they didn't say by much—of their July projection that al products would produce $275 mil- to $325 million of operating earnings year, vs. $46 million in 2004. Brust forecasting amid so much change is cult. "There are a lot of moving s, but we're more in a steady state ," he says.

NA GOES STRAIGHT TO DIGITAL

AK'S WOES highlight the financial ns faced by established companies n disruptive technologies erode their tional revenue streams. As many me- companies, music retailers, and o-rental chains can attest, the prob- are compounded by the speed at h digital technology spreads around lobe. "Digital was supposed to be the nised land, and it is turning into a np," says James S. Chanos, founder oney manager Kynikos Associates, is betting that Kodak shares will fall. sinesses with these major paradigm s to digital products just see their flows from analog products evapo- much faster than people are used to."

Kodak, executives had hoped that ging markets such as China would them more time to wind back the and photographic-paper business as ricans switched to digital cameras. ad, buyers in new markets skipped film and went straight to digital. So ly, Kodak raised its layoff target from the 15,000 announced in January, 2004, to as many as 25,000 jobs. It vowed to eliminate $2 billion, or two-thirds, of its traditional business assets by the end of next year. It is even cutting capacity in China.

The speed of the collapse of its traditional business lines has pushed Kodak into a cash bind. Severance and other restructuring bills will gobble up $300 million in the second half of this year and $650 million more next year, when the $750 million of debt comes due—for a total of $1.7 billion. At the beginning of July, Kodak had just $553 million in cash on hand. Brust predicts he will have enough money to close the gap. Typically, Kodak generates most of its cash in the second half of the year—$1.1 billion last year. He plans to raise $600 million by selling real estate and patent rights; he's also liquidating inventory and cutting capital expenditures.

BIG SELLER Kodak has 22% of the U.S. market

Then there's Kodak's surprising decision to make fewer consumer digital cameras and printers in case holiday sales falter. Even so, Brust is taking no chances. He has negotiated a bank commitment to refinance $500 million of debt if he needs to.

Should things not go as planned, Kodak would be unlikely to find it easy to raise cash in the bond or stock markets. Its shares are down 27% this year, to 2003 levels. Bond investors are dumping the company's debt, too. Besides the missed projections, what's frustrating them is that Kodak is giving banks security for the new loan package and putting their $2.2 billion of unsecured debt at a disadvantage. Pessimists such as Chanos think Kodak's write-offs will continue and that the company will ultimately have to restructure its debt—in or out of bankruptcy court.

Not everyone on Wall Street is down on Kodak. Bill Miller, chief executive of Legg Mason Capital Management and portfolio manager of Legg Mason Value Trust, the only mutual fund to beat Standard & Poor's 500-stock index for the past 14 years straight, is a big fan. He holds some 42 million Kodak shares, 15% of the company's equity, including 3 million bought earlier this year. Despite having lost money on the stock—he began buying in 2000 when it was twice as high as its recent $23—he believes the shares will turn around. "Once these cash charges are gone, we expect [Kodak] will have free cash flow of more than $1 billion, conservatively," says Miller. He figures that will make the company worth more than $16 billion and $50 a share. Then, Miller says, double-digit profit growth will kick in, thanks largely to Kodak's commercial-graphics business. Built up with a half-dozen acquisitions over the past two years, the division is getting ready to sell more machines capable of personalizing slick junk mail and printing everything from colorful store merchandising banners to lottery tickets. "The real payoff begins after 2008," Miller predicts.

All the same, there are risks to his rosy scenario. Some people are turning away from printing photos at home or anywhere else. Doctors in U.S. hospitals are increasingly viewing X-rays on video monitors, while youngsters are looking at one another's digital pics over the Internet without bothering to make prints.

Kodak executives, while exuding optimism, are preparing a change in the company's organization that could make it easier to sell off assets. Starting in January they'll divide the company into four distinct units—consumer digital, commercial printing, health care, and traditional film—each with its own financial report. "It will be up to the board to decide what is the best option," CEO Perez recently told securities analysts. "We don't have anything for sale." At least not yet. ■

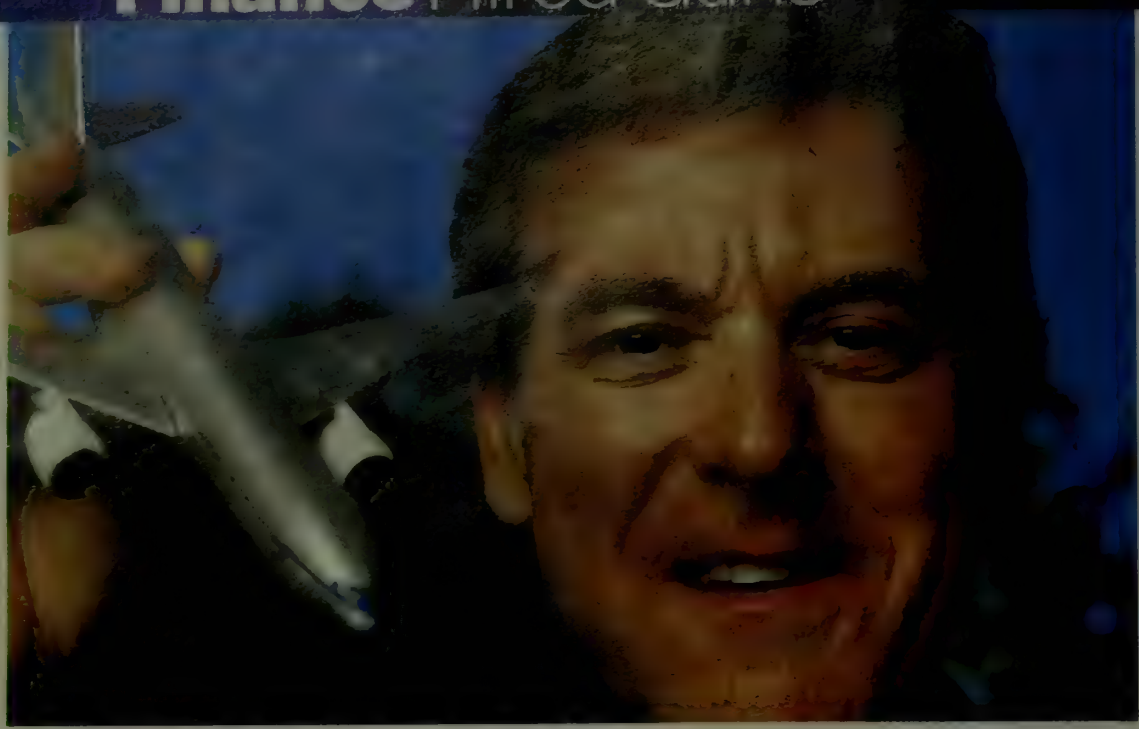
–By David Henry in New York

Painful Transition

The speed at which digital technology has spread is putting Kodak's finances under increasing stress:

- Its **film biz** is declining by 25% a year—more than three times faster than expected
- Profits from new **digital ventures** are falling short of targets
- **Plant closures and layoffs** will cost $1 billion over the next 18 months
- **Debt** of $750 million is scheduled for repayment next year

Data: Company reports, *BusinessWeek*



ROSENTHAL Saybrook could help shape the airline industry's future

The Sweet Smell Of Chapter 11

Saybrook Capital specializes in 'big, ugly' bankruptcies. Today, that means airlines

NESTLED 3,000 MILES from Wall Street in the beachside town of Santa Monica, Calif., Saybrook Capital is an unlikely player in the rough-and-tumble world of bankruptcies. But since it started in 1990, the 60-person boutique investment bank has carved out a key role in some of the country's largest bankruptcies, advising creditors of Pacific Gas & Electric and shareholders of Kmart and Adelphia Communications. Often it competes against much bigger firms such as Lazard and Rothschild. "We tend to get the deals that are big, ugly, and complicated," says Jonathan Rosenthal, who runs the firm's bankruptcy practice.

Now the firm is knee-deep in the airline industry, where three of the four largest carriers are in Chapter 11. Saybrook has been advising the official committee of creditors of United Airlines parent UAL Corp., which filed for bankruptcy in 2002. Saybrook is short-listed to do the same with both of the two carriers that filed on Sept. 14—Delta Air Lines and Northwest Airlines. Creditors will choose advisers in the next few weeks. Saybrook may have the inside track over three rivals for the Delta job because it has been representing creditors informally for 15 months.

So Saybrook figures to have a seat at the table as the U.S. airl industry is reshaped. "visers have a lot of say o who wins and who los in bankruptcy court, s Rosenthal. "Bankruptc a powerful tool and can used for all kinds of thin including mergers." expects carriers emerge from bankrup with drastically redu costs to enable them compete with low-cost c riers such as Southw Airlines. And he fores mergers over the next c ple of years: "You're go to take seats out of the s tem, and that will improve yields."

Rosenthal has proved adept at mold reorganization plans. In the 2001 PG&E bankruptcy, the utility wanted to its assets to wholly owned subsidiaries plan that Saybrook considered doomed an unusual move, Rosenthal, who ha law degree from Southwestern Univers persuaded the judge to terminate PG& right to set its own plan and submitted alternative that kept the company int "Jon was extraordinary at crafting so thing that worked for the creditors a could bring the utility and regulators i consensus," says Jerry R. Bloom, a law at White & Case LLP who co-chaired unsecured creditors' committee. PG eventually accepted the alternative. Cre tors got one of the largest U.S. bankrup settlements ever—$15 billion, or $1.06 the dollar (the market value of their bo rose as interest rates fell).

Taking on the problems of the airli comes naturally to the 50-year- Rosenthal. In the 1980s he founded a ran NetAir Internatio Corp., then the largest U charter jet company. It one reason he won UAL assignment.

The UAL case has tur into a behemoth. Saybr has spent 21,000 hours it—advising on the renego tion of 660 aircraft leases a collective-bargaining agr ments with seven unions, a on the largest pension-p terminations ever. Just wh UAL thought it had costs der control, fuel pri

Disaster Recovery

Saybrook Capital has won billions for creditors and shareholders in major bankruptcy cases

DEBTOR	CLIENTS	RESULT
KMART	Shareholders	Market cap rose by $6.9 billion
PACIFIC GAS & ELECTRIC	Unsecured creditors	Won $15 billion, or 106% of outstanding claims
ORANGE COUNTY, CALIF.	Municipal bondholders	100% of creditors' claims, or $5 billion

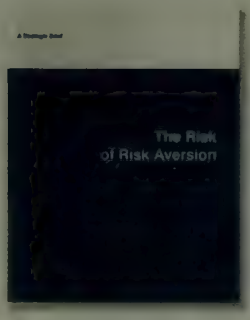
Data: Saybrook Capital

The Risk of Risk Aversion #2 in a series of strategic briefs

"WITH BONDS, THERE'S REAL DOWNSIDE IN WAITING FOR MORE UPSIDE."

Fixed-Income Strategists
George Friedlander
and Michael Brandes

Right now, some investors are wary of bonds because they think interest rates will rise further. If you're one of them, have you considered all the benefits you're sacrificing while you wait? Or how risky this is to your portfolio? That's why we wrote *The Risk of Risk Aversion* — to make sure investors understand the many forces that should continue to keep interest rates relatively stable, along with the critical role bonds play in your portfolio.



Call 1-800-327-6748, ext. 541 or visit smithbarney.com for your copy of *The Risk of Risk Aversion*.

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soared, forcing more cuts. "UAL has taken longer and has absorbed more resources than we had anticipated," Rosenthal says. UAL expects to emerge from bankruptcy in February. Creditors may not be so happy with the outcome: UAL projects unsecured creditors will recover between 4% to 7% of their $28 billion in claims. But Rosenthal says he's pleased: UAL's bonds are trading at 14¢ on the dollar, vs. 6.5¢ when Saybrook took the case.

RISKY MOVE

DELTA COULD BE the next order of business. Last year, Rosenthal expected its troubles to get worse and accepted an invitation to begin organizing unsecured creditors, which includes banks, aircraft companies, and unions. It was a risky move. Saybrook worked for free, betting that Delta would seek bankruptcy-court protection and that creditors would tap Saybrook as their paid adviser. The assignment could be lucrative. Saybrook typically gets a flat monthly fee and a share of what's recovered. It has collected $6.9 million from UAL so far.

Extracting money from bankrupt concerns isn't a cheery way to make a living. "It's like being the coroner," says Rosenthal, who lives in Los Angeles with his wife and two children. "I've had friends drive up when I'm standing outside Starbucks, roll down the window, and say, 'Is there something wrong here?'" It doesn't help either that bankruptcy advisers often have sharp elbows. However, Rosenthal is known as a bit of a diplomat. "J.R. has a personal touch that helps him achieve things that someone at a small firm would otherwise have difficulty doing," says James S. Feltman, senior managing director at Mesirow Financial Consulting, a competitor and occasional ally of Saybrook's.

Surprisingly, many of Rosenthal's most valuable assignments have come from former opponents. While advising Lehman Brothers Inc. in the 1990s, he locked horns with Andrew Clare, who represented Lehman's creditor, First Interstate Bank. "We fought like cats and dogs, really screaming and yelling," Rosenthal recalls. The day after the case closed, Clare called to ask Rosenthal to advise First Interstate on another matter. "I was stunned," Rosenthal says. Despite the fighting, Clare had admired Rosenthal's deportment. "He was very smart, but he didn't shove his intellect down your throat," Clare says. It pays to be diplomatic when you're the coroner. ■

–By Justin Hibbard in San Mateo, Calif.

RESEARCHERS

Analyze This: A Vanishing Portfolio

Spare a thought for beleaguered airline analysts. During the industry's four-year slide they've put in endless hours, mastering every issue from jet-fuel hedges to pension fund deficits. Their reward? With three of the country's top four airlines now in bankruptcy, airline analysts are left with little to analyze.

So they're scrambling to survive any way they can—reinventing themselves as airline debt experts, branching out into foreign carriers, or boning up on discount and regional outfits. Their goal: avoid the fate of their colleagues at Credit Suisse First Boston, which jettisoned airline coverage in January. Zacks Investment Research tracks just 32 airline analysts now, 11 fewer than in 2002. "It's been very volatile," says David Strine, Bear Stearns & Co.'s airline analyst. "Sleep has been really hard to come by."

Airline analysts turn to aerospace or debt

Strine is rebranding himself as an Asian specialist, with carriers such as Korean Air and Taiwan-based China Airlines Ltd. now representing nearly half of his coverage list. "We're going global," he says, "and we're going more global." The move was a natural for Strine. He started as an analyst for Bear Stearns in Hong Kong in 1997, just before the Asian economic turmoil began. Strine says the experience of sizing up companies in crisis mode came in h when he moved to New York and late over the firm's airline coverage in the of 2003—when the industry was in t midst of its post-September 11 crisis

Calyon Securities Inc.'s Raymond is casting a wider net: He's diversifyi aerospace manufacturers such as Bo Co. and Brazil's Embraer. "That's how survive—expand," he says. Neidl, a fo junk-bond analyst who's based in Ne is also trying to make himself indispensable by being the go-to guy distressed airline debt. "There's just a hedge-fund interest in all the busted c he says. He still covers Continental Ai Inc. and AMR Corp., two U.S. majors bankruptcy court, but he doesn't recommend either. He'd rather chat u clients about profitable regional carrie such as Mesa Air Group Inc. and Repu Airways Holdings Inc., and foreign ups like Brazil's GOL Linhas Aéreas Intelige and WestJet Airlines Ltd. of Canada.

Hedge funds and private equity firm have joined mutual funds as big consu of airline research. At AirlineForecasts, Washington research firm, a hedge fun recently commissioned a 10-year forec of probable survivors and failures. Anot says CEO Vaughn Cordle, ordered a 33-page analysis of likely merge which he prepared with the h of a furloughed CSFB analyst can't handle all the work," say Cordle, an active pilot and chartered financial analyst. " working my butt off."

With more airline bankruptcies expected and hi of more analyst layoffs in the a many Wall Streeters are reluctant to talk. But some fol are hopeful. "These are essential service providers, and half of them are profitable says Merrill Lynch & Co. analyst Michael Linenberg, who co-heads the New York Society of Airline Analysts. "There will be winners that emerge from the crisis," adc Strine. "The airline industry is not going t disappear." Even so, he's hedging his bets He also covers a Chinese railway.

–By Roben Farzad in New Yo

meet the CEO of section 15

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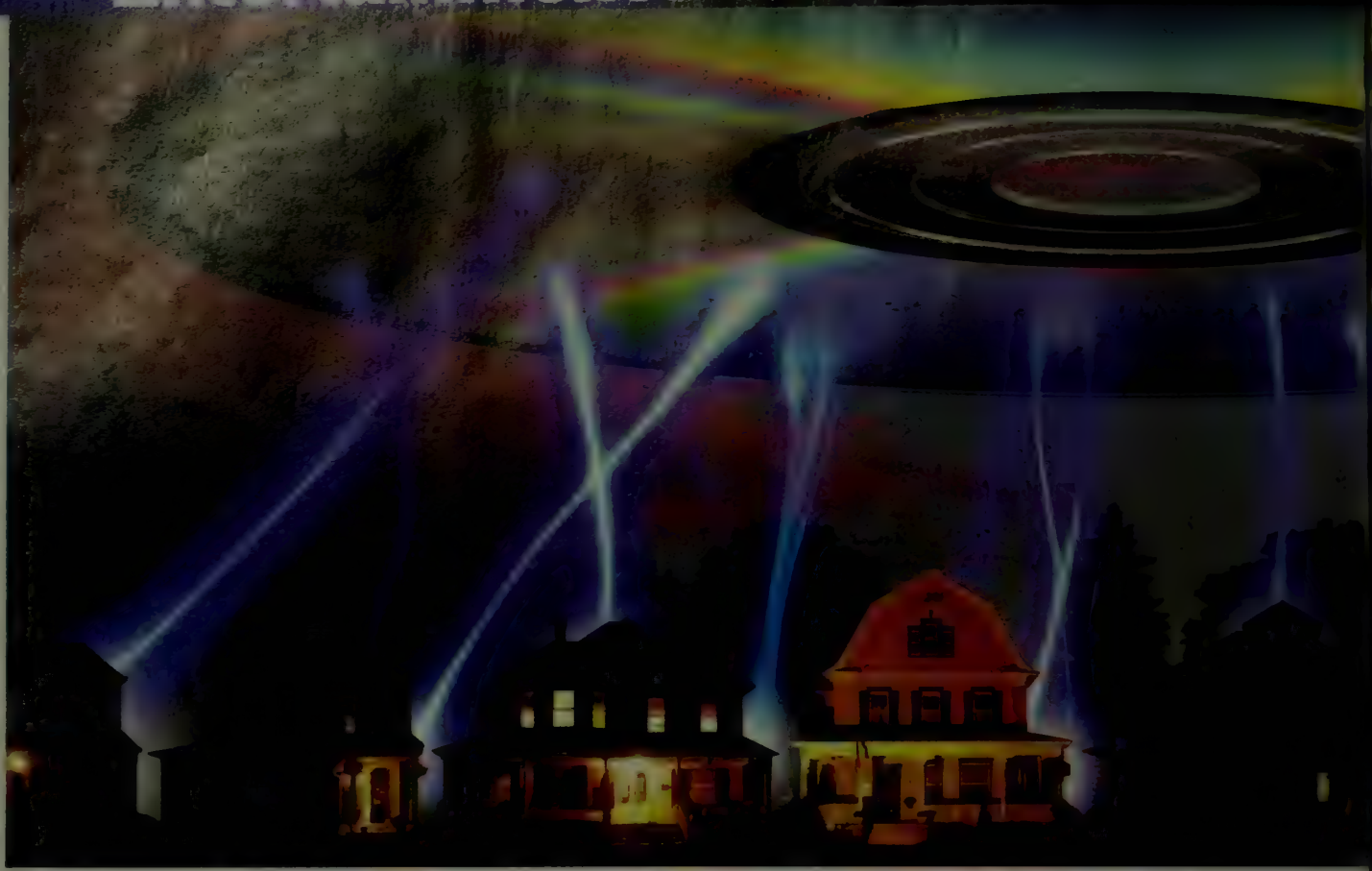


Daggers Drawn Over DVDs

How Sony gained an edge in its fierce battle with Microsoft over video formats

EVERY JULY, 400 OF THE most powerful media and tech industry chieftains meet at investment banker Herb Allen's conference in Sun Valley, Idaho, for what are usually convivial discussions of megatrends and megamergers. But this year, Microsoft Chairman William H. Gates III laid into Sony Chief Executive Howard Stringer, according to two sources, including one who witnessed the exchange in a private room. Gates argued that Sony's new high-definition DVD standard, called Blu-ray, needed to be changed so it would work smoothly with personal computers running on Microsoft's Windows operating system. Stringer and two lieutenants defended the technology, insisting Blu-ray would work fine in PCs. Yet Gates's ire only grew. "There must be something much deeper going on," Stringer said later, according to another person who heard the comment. A Microsoft spokesman acknowledges that Gates and Stringer talked at the conference, but says things did not become "heated."

Gates's efforts to derail Stringer's plans soon became public, though. On Sept. 27, Microsoft Corp. and Intel Corp. fired a broadside at Sony Corp., suggesting publicly the company's Blu-ray technology couldn't deliver what it promised, and they pledged their support for a technology from Toshiba Corp. The m touched off a torrent of recriminat and finger-pointing. Several movie dios quickly voiced their support for S Two major Chinese DVD makers ba the Toshiba standard, which is called DVD. And Dell Inc. and Hewlett-Pac Co. took the highly unusual step of i ing a joint statement denouncing move by Microsoft and Intel, the PC m ers' two most important suppliers. "I peration" is the way Brian Zucker, a t nology strategist at Dell, character Microsoft's move.

CRITICAL MASS

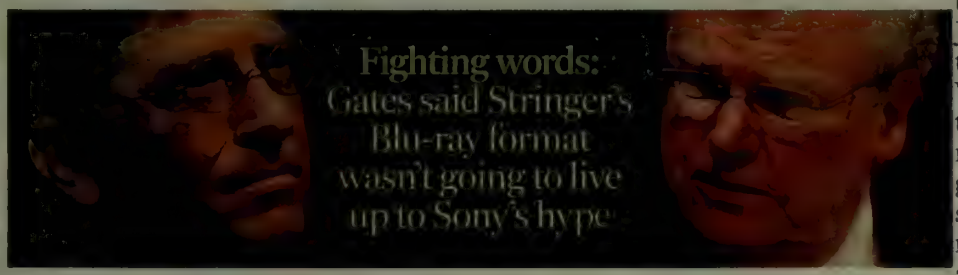
IT MAY AMOUNT to little more than t Despite the backing of the PC indus two biggest titans, it looks as if HD DV days are numbered. Sony is lining strong support among Hollywood stu as well as other consumer-electro companies. On Oct. 3, Paramount tures Corp. announced it would end clusive support of HD DVD and sup both standards. Warner Bros. Inc. is pected to follow suit in the next few d sources say. That'll give Sony six of seven major studios. Sony may nego a deal to give a slice of Blu-ray royalti Toshiba, and perhaps even Microsoft that would largely be a face-saving c promise. Sony appears to have a cri mass of support for its standard.

major factor swaying these compa-
s Blu-ray's massive capacity. Its disks
old at least 50 gigabytes and perhaps
gigs or more. HD DVD will start at 15
and top out at 45. "We want a stan-
that's going to be around for 10 or 15
," says one studio exec. Microsoft's
ism is that Blu-ray disks will be more
nsive to manufacture and may be im-
ble to make in
volumes. Yet
echnology's sup-
rs are con-
d costs will be
ar over the long
"We don't see
big cost differ-
and we know a
or two about
me manufacturing," says Michael S.
chairman of PC giant Dell.

ny is so much vitriol spilling from
d closed doors over one tech stan-
? The shiny little disk that Gates and
ger tangled over has the potential to
the landscape of the entertainment
echnology industries. Next-genera-
DVDs will feature high-definition
es, extras like movie-themed com-
games, and the ability to download
railers from the Internet. Tech play-
media companies, consumer-elec-
cs giants, and retailers are brawling
e advantage of the new financial and
gic opportunities. "It's like the old Irish saying: 'Is this a private fight, or can anyone jump in?'" says Paul Saffo, director of the Institute for the Future.

For each side, the stakes are huge. Movie studios, struggling with a sudden slowdown in the $18 billion-a-year U.S. DVD market, are salivating over the chance to entice consumers with movies on new high-definition disks. Consumer-electronics makers—which increasingly include Dell and HP—are banking on people thirsting for more high-definition gear, from DVD players to big-screen TVs. And Microsoft and Intel, hungry for new growth opportunities, want to expand their roles in people's lives, helping them manage digital photos or download the next Batman flick off of the Net.

Behind the brinkmanship lie two vastly different views of where entertainment in the home is heading. Microsoft and Intel paint a futuristic picture of the digital home, with sleek PCs powered by their software and chips in the central role. The PC would shuttle music, photos, and video from room to room—and grab off the Web everything from the latest Tom Cruise blockbuster to a National Public Radio podcast.



Fighting words: Gates said Stringer's Blu-ray format wasn't going to live up to Sony's hype

Sony and its supporters are skittish about the latest movies being zipped around the house. Blu-ray disks can hold more content than today's DVDs, but they would be used in much the same way. The new disks would be plopped into a DVD player, and copyrighted material, like Hollywood movies, couldn't be ripped to a computer's hard drive without a studio's permission. Blu-ray equipped devices are even designed to recognize and refuse to play pirated movies. Such protections are another big reason Sony has won the support of studios, such as News Corp.'s Fox.

No company has more at stake than Sony. Long one of the most innovative companies in electronics, it stumbled badly in recent years. With Blu-ray, it has the opportunity for a triple play. It'll reap royalties from all the disks sold with its technology. Its movie business could see a resurgence in lucrative DVD sales. And it could see sales soar for its electronics gear, including HDTVs, movie cameras, Blu-ray optical drives, and especially its new PlayStation game consoles, which will include a Blu-ray drive for playing movies. Sony's people have "bet the entire future on this," says analyst Michael Pachter of Wedbush Morgan Securities. "It's too important for them to lose, so they will do everything they can to win."

HIGH-TECH INTRIGUE

THE STORY OF how Sony and Stringer maneuvered their way into what looks like a winning position in the DVD wars includes enough intrigue to fill more than a few disks. The backdrop is Sony's famous failure two decades ago to establish Betamax as the standard for videotape, despite its widely recognized technological edge. It lost out to Matsushita's VHS, in part because its onerous licensing terms alienated the Hollywood studios.

Then in the 1990s, Toshiba outmaneuvered Sony to establish the standard for today's DVDs. The Japanese company teamed up with Time Warner Inc. on the technology, using the media giant's clout to get other Hollywood studios on board. The result is that Toshiba and Time Warner rake in the lion's share of the royalties generated by DVDs. No one has disclosed precisely what those royalties are, but they run into the hundreds of millions of dollars.

Toshiba looked as if it could win the battle for high-definition DVDs too. After Sony and partners Philips and Matsushita began work on Blu-ray, Toshiba in 2003 hired former Warner Bros. video chief Warren Lieberfarb to lobby for studio support. It was a savvy move, since it was Lieberfarb who had won the studios backing for the first DVD standard. By November, 2004, the assault appeared to be working—with Warner, Paramount, Universal, and New Line Cinema seem-

ingly firmly in the Toshiba camp.

With so much at stake, Sony went on its own recruiting campaign. It quickly signed up some of the biggest names in consumer electronics, including Samsung and Sharp. By early 2005, Dell, HP, and Apple Computer joined the industry standards group. The electronics makers think Blu-ray has the greatest chance to prompt consumers to start opening their checkbooks for new gear.

Microsoft at first stayed out of this tug-of-war. Instead, it focused on selling its software to both sides. The Toshiba camp first agreed to use a piece of Microsoft software, its VC-1 codec, that squeezes content onto the disk, then decodes it for viewing. Then, in September, 2004, the Blu-ray backers adopted this chunk of code as well—in exchange for a public pledge of neutrality from Microsoft. "[illegible] wanted them to join us," says an insi[illegible] who is close to the Blu-ray Disc As[illegible] "But we compromised on neutralit[illegible]

That neutrality has unraveled over [illegible] past year, as Microsoft increasingly ca[illegible] to see Blu-ray as a risk to its fortunes. [illegible] May, Sony confirmed that it would [illegible] clude Blu-ray in the new PlayStat[illegible] game console beginning next year. [illegible] crosoft's Xbox wouldn't have such ca[illegible] bility. Then on June 15, the Blu-ray ca[illegible] decided against using Microsoft's [illegible] technology to add interactive feature[illegible] Blu-ray disks, opting instead to stick w[illegible] software based on Java technology.

Blu-ray vs. HD DVD

Which technology will be used to deliver next-generation DVD to the masses? Sony's Blu-ray, backed by an army of electronics, content, and technology companies, has the advantage over Toshiba's HD DVD.

CONSUMER ELECTRONICS

SONY A victory for Blu-ray would add hundreds of millions in licensing revenue and propel Sony to the top of the market for high-definition DVD players. And Blu-ray drives in its PlayStation 3 could give Sony an edge over Microsoft's Xbox 360.

PANASONIC, SHARP Two of the leading HDTV makers, both plan to make Blu-ray DVD players exclusively. They believe that Sony's decision to put the technology inside PlayStation 3 consoles will seed the market.

TOSHIBA Having won the standards war that led to current DVDs, Toshiba wants to keep millions of dollars in royalty payments coming from its HD DVD patents. The windfall this time around could be even more handsome.

AMOI ELECTRONICS, CHANGHONG ELECTRONICS In late September, two of China's biggest DVD player makers threw their support to HD DVD, saying they would be cheaper to manufacture and market.

MEDIA

DISNEY, FOX, MGM Eager to boost DVD sales, studios are betting consumers want extra content that can be stuffed onto Blu-ray disks, which hold far more data than HD DVDs. The studios see Blu-ray providing more protection against illegal copying.

TIME WARNER, PARAMOUNT Both companies had been firmly in the HD DVD camp. Now convinced that Blu-ray could be adopted faster, both are considering support for Blu-ray as well.

PC INDUSTRY

MICROSOFT, INTEL The two tech giants are banking on the PC to emerge as a hub for digital entertainment, shooting programming to other players around the home. Microsoft is also loath to give Sony any advantage in the game console war.

DELL, HP, APPLE These PC makers believe Blu-ray will win over users faster than HD DVD, and this should speed sales of higher-margin PCs with high-def DVD players. Dell and HP sell HDTVs as well, and sales of those sets could jump, too.

RETAILERS

WAL-MART The retail giant fears that dueling high-definition formats will confuse consumers and slow sales. So it has told the battling sides that it will stock only one format, though it hasn't picked a side. The loser will find itself shut out.

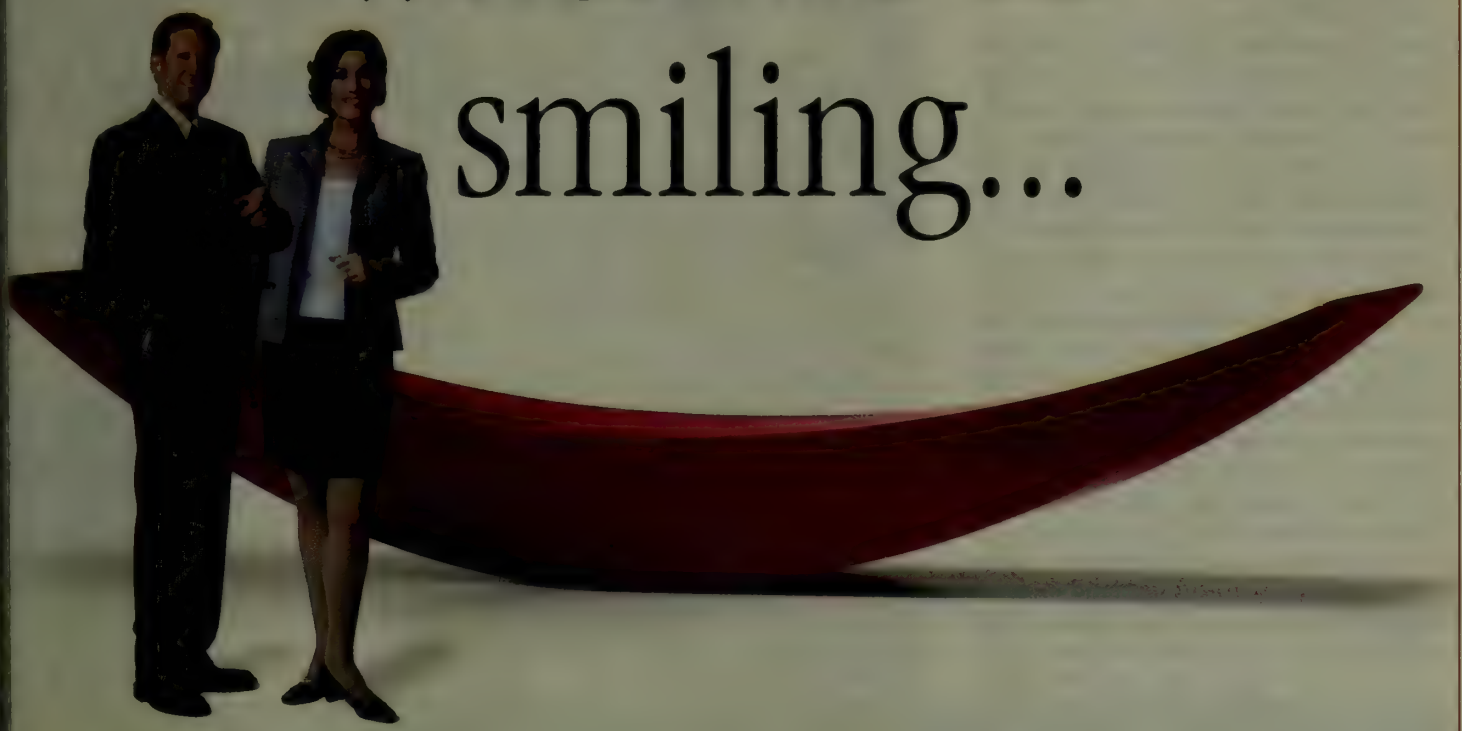
FIGHTING PIRATES

IN JULY, SONY DECIDED to refine [illegible] Blu-ray standard in a way that wo[illegible] have far-reaching implications for [illegible] crosoft. Sony wanted to win the supp[illegible] of Twentieth Century Fox Film Studi[illegible] long Hollywood's leading advocate [illegible] tough anti-piracy measures. So S[illegible] agreed to add safeguards developed [illegible] Fox by San Francisco's Cryptography [illegible] search Inc., which could prevent Blu-[illegible] movies from being ripped to a comput[illegible] hard drive. Fox execs say their decis[illegible] became a no-brainer, because of the e[illegible] protection and because as many as [illegible] million PlayStations might be sold in [illegible] next three years. "They have a Tro[illegible] Horse that will play a critical role in [illegible] niting the market for this product, [illegible] when they do, we intend to be in t[illegible] market with them," says Michael Du[illegible] president of Fox Home Entertainmen[illegible]

The move was a serious blow for [illegible] crosoft's Xbox. The company had deci[illegible] to hold down costs by not includin[illegible] next-generation DVD player in the ga[illegible] console. Instead, it planned to stre[illegible] high-definition content from a PC sitt[illegible] in one room to the console, which wo[illegible] be attached to a television. But Cryp[illegible] graphy's safeguards meant studios co[illegible] block their content from being taken [illegible] the DVD. That was the reason for Gat[illegible] exchange with Stringer at the conferen[illegible] Gates wanted Sony to drop such techn[illegible] ogy, but Stringer wouldn't budge.

Meanwhile, Sony's camp received h[illegible] winning over one influential studio fr[illegible] an unlikely source. Raider Carl C. Ica[illegible] one of Time Warner's largest shareho[illegible] ers, began pressuring the studio to f[illegible] ways to boost its stock price earlier [illegible] year. Despite Time Warner's long allia[illegible] with Toshiba, CEO Richard D. Pars[illegible] asked Jeff Bewkes, chairman of the co[illegible] pany's entertainment unit, to recons[illegible] the best way to recharge DVD sales. B[illegible]

When we're smiling...



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kes decided that the studio should forget appearances and back Blu-ray if it was the format most likely to win consumers' hearts. "Blu-ray's potential for more capacity started looking better and better," said one Hollywood executive.

CRISIS MODE

ONCE WARNER STARTED to waver, Paramount Pictures decided to move first in order to negotiate better terms, according to Hollywood insiders. On Sept. 23 one Blu-ray insider saw preliminary contracts written up by Warner Bros. and Paramount to join the Blu-ray board. "It was all going to happen in a day or two," says the source.

Leaked to Microsoft, the news put the company in crisis mode. Execs began working the phones, lobbying retailers about the potential for mass consumer confusion if competing standards came to market. Concerned, CEO H. Lee Scott of Wal-Mart Stores Inc. personally telephoned Stringer and Walt Disney Co. CEO Robert Iger, two Hollywood sources say. Finally, Microsoft issued its joint statement with Intel. Microsoft declined any additional comment for this article.

The public attack may have backfired. One day after Microsoft talked up the importance of Toshiba's ability to hit the market first with its standard, Toshiba announced it would delay rolling out its own HD DVD players until after the holidays. Sony's Blu-ray-equipped PlayStations are scheduled to go on sale early next year, too. The same day, Yoshihide Fujii, Toshiba's corporate senior vice-president for digital media products, said the company remained open to creating a single format.

Such a compromise would avoid the confusion of two technologies coming to market next year. A few components of Toshiba's technology, and possibly Microsoft's, could be incorporated into Blu-ray to make it easier for them to join Sony. While Sony may agree, it is taking steps to avoid any substantial delay in Blu-ray. Sources say the company is considering reducing its royalty take and may underwrite the production costs of Blu-ray disks.

It may not be the Sony of old. But a Blu-ray victory would help the company regain a starring role in living rooms everywhere. ■

–By Cliff Edwards and Peter Burrows in San Mateo, Calif., and Ronald Grover in Los Angeles, with Tom Lowry in New York and Kenji Hall in Tokyo

BusinessWeek online For additional information on the DVD wars, go to businessweek.com/extras

CONSUMER ELECTRONICS

Definitive Answers On High-Def

Can't wait until you can get the eye-popping detail of a movie at the multiplex right in your living room? Even if you're ready for high-definition DVDs, the market isn't ready for you. That won't happen until next year, when the players and disks will go on sale.

Before then, there's still a lot of behind-the-scenes wheeling and dealing to be done over which formats and features will be offered. But the good news is that the transition to high-definition DVD players promises to be a lot less wrenching for you than technology shifts in the past. The new super DVDs aren't likely to immediately make your DVD movies obsolete in the same way CDs supplanted vinyl LPs and DVDs replaced videocassettes.

But high-definition TV, which gets its compelling leap in picture quality from screens that show three to six times the detail of standard TV, clearly is here to stay. Stations are broadcasting more HD programming, and families are replacing aging TV sets with HD models. Some 10% of U.S. households now have one—and perhaps a third will within three years. So Hollywood figures it needs a way to distribute HD versions of its movies.

Eventually you're going to have to make some decisions about upgrading your DVD collection or adding to it with high-definition disks. Here's what you need to keep in mind:

>> **YOU PROBABLY WON'T** be forced to choose between competing formats Blu-ray, developed by Sony Corp., and Toshiba Corp.'s HD DVD. Chances are slim that more than one type of player will make it to market, and Blu-ray is the front-runner. If, come next year, the industry stubbornly offers you a couple of incompatible DVD players and disks, it's best to continue to fence-sit until one side in the battle surrenders.

>> **YOU'RE NOT GOING TO** have to replace your DVD library. Both of the proposed schemes will let you play your current movies in the new players, and the new disks probably will work in the DVD player you already own. You won't get the benefit of the richly detailed high-definition picture, but at least your current collection of DVDs won't end up deep in the basement alongside your videocassettes.

>> **YOU'RE GOING TO** have to pay more for high definition—for the players, a lot more. The first ones probably will go for $750 to $1,000. The cheapest way to get into the game may be to buy Sony's PlayStation 3 game console, also expected next year, for $500 or less. It will have the new DVD player on board. The longer you can hold off, the better the deal you'll get.

>> **YOU'LL SPEND MORE,** but you'll also get more with the new disks. They're pricer—$20 and up instead of $20 and down—which means retailers will continue to sell standard DVDs next to the HD versions of most movies. In addition to better picture quality, you can expect more extras, including the ability to connect to the Internet to buy games and knickknacks related to the movie.

Oh, and one more thing: You'll need a high-definition TV to get full benefit from high-definition DVDs. If you're in the market for a new set and you're an avid enough video fan to be worried about your DVD collection, you should start shopping for an HDTV. Unlike the new DVD players, you'll find plenty of HDTV deals around this holiday shopping season. But deals on high-def DVDs and players? Those are still a long way down the road. ■

–By Larry Armstrong in Los Angele

Hey, Advertisers, TiVo Is Your Friend

New-Media ad guru Rishad Tobaccowala is showing big-name clients how to get results

IT'S A WARM SEPTEMBER DAY IN Manhattan, and Rishad Tobaccowala is standing in front of about 40 top advertising agency consultants in one of Starcom MediaVest Group's small auditoriums. The consultants, who steer advertisers to the right agencies, are cranky. They have been feted all week by more than a dozen leading agencies in New York—every one, that is, except Tobaccowala's SMG. Instead of lavish trays of food, the ad agency brings in deli fare. SMG is short on chairs, too, so a half-dozen high-powered consultants lean against the walls. As Tobaccowala finishes his riff on how the agency's clients are abandoning consumer demographics in favor of targeting buyers' passions, be they ballet or hunting, he introduces a "real hunter," John Muszynski, one of the top execs at SMG, which is owned by France's Publicis Groupe. "Seriously," Tobaccowala says. "He goes out and kills things." The banter draws nervous titters.

Tobaccowala can get away with this because he's one of the industry's leading media strategists, and that makes him one of the new oracles of Madison Avenue. Media strategists are the people who decide where to spend advertising dollars—across Yahoo's sites, on ABC's *Desperate Housewives*, or in *The New York Times* Sunday Styles section. They used to rank just above accountants as the kind of people advertisers wanted to meet in the industry. In recent years, however, disdain has been replaced with adulation as the attention spans of consumers have shrunk. With the Internet, ad-skipping digital video recorders (DVRs), video cell phones, and portable music and video players all vying for their attention, consumers are getting harder and harder to track. And that's putting media strategists on the speed dials of advertisers befuddled by the changing landscape.

With a sterling track record, Tobaccowala is first among the new stars of ad agencies. What the 47-year-old, India-born

PLAYBOOK: BEST-PRACTICE IDEAS

What Works Now

Starcom MediaVest's Rishad Tobaccowala has earned a reputation as one of Mad Ave's freshest thinkers. Here's a look at his philosophy:

MARKET IN A SOCIAL WAY ▼
Starcom clients Best Buy, Sara Lee, and P&G have led the way in embracing the latest Web technologies, including social networking, podcasting, and tagging. P&G worked with CBS to crank out a podcast of the nearly 70-year-old soap opera *Guiding Light*.

THINK VIDEO, NOT TV ▲
The 30-second broadcast TV spot is old hat. Tobaccowala worked with P&G to develop 60-second documentary-style films for its Cover Girl makeup line. The videos run on television, Web sites, and cell-phone screens.

EMBRACE ON-DEMAND ▲
Many in the ad industry think new technologies, such as TiVo, that let consumers watch TV or movies when they want, spell doom for advertisers since consumers can skip over ads. Not Tobaccowala. He's been pushing clients to grasp the opportunity of these technologies since 2003. BMW and GM, for instance, have been experimenting with ads two minutes or longer, with more information and more drama.

MOVE BRANDING ONLINE ▶
Two years ago, Tobaccowala began encouraging clients, including Miller Brewing and Kellogg, to build their brands online with video ads and interactive banner ads. In 2003, Starcom pioneered the first "upfront" buying season with Yahoo!, America Online, and others, similar to the way advertisers buy buckets of TV time for the fall season.

chief innovation officer may sometimes lack in tact, he makes up for with a proven compass. He's a pioneer of online advertising, insisting back in 1993 that his ad agency, Leo Burnett Worldwide Inc., spin off an interactive ad unit that he would head. He persuaded big-name clients, including General Motors Corp. and Procter & Gamble Co., to stay committed to the Web during the downturn. In 2002 he pressed SMG to form a video-gaming unit, getting a jump on rivals in figuring out how to place brands in games. A year later he drove the first up-front buying season for marketers to purchase broadband ad space from Yahoo and America Online Inc., just as they buy buckets of TV time from broadcast networks six months before the new programming season.

MORE SCIENCE, LESS ART

THIS FUTURIST DOESN'T dwell on successes of the past, though. Tobaccowala's message to clients now is that they must get used to being in a permanent state of discomfort. The forces unleashed by tech on the ad world are gaining momentum and leading to ever more unexpected developments. "Blogs and podcasting have gone from 'What are those?' to mainstream in less than two years. Rupert Murdoch paid $580 million to acquire a social-networking business [MySpace.com], and Google's market cap is higher than Viacom's," he says. "So where is the steady state?"

He's less than impressed with some of the supposed solutions offered by others on Madison Avenue. One example: product placements in movies and TV, a common tactic advertisers are using to combat the popularity of DVRs. Tobaccowala dismisses most of them as "lazy" and then adds an expletive that can't be printed in a family magazine. "The spine of our business has collapsed, and what we are looking at are the organs, blood, and connective tissue on the floor in a pile of goo," he says. "We have to imagine what the new structure is going to look like."

He dismisses most product placement as "lazy"

His advice? Adapt to consumers' changing behavior rather than try to cling to the status quo. People's preference for consuming content when they want it will only grow, he says. He predicts 30% of U.S. homes will have DVRs in less than two years. Pair this preference for on-demand content with the ability to search for video on Google or Yahoo, download it over speedy broadband links, and zip it to the living room TV, and traditional TV schedules will be rendered meaningless.

Tobaccowala sees loads of opportunity in this new world. Think of how people get lost for hours surfing the Net now, he says. In the near future they'll start doing that with flat-panel TVs in their living rooms. And advertisers will have much more information they can use to target particular viewers. Rather than knowing simply what percentage of 18- to 25-year-olds watch *Desperate Housewives*, they'll be able to figure out which people watch, how frequently, and what they've been searching for recently on the Net. Advertising can become more science and less art. "[Tobaccowala] talks like a truck driver, but his mind works differently than most people's, and that's what makes him valuable," says Linda Fidelman, president of Advice & Advisors, a consultant for agency searches.

TOBACCOWALA In two years, SMG's media-strategies biz has grown by $5 billion

Traditional media, from television to newspapers, will continue to be plenty important, he says. But he thinks they need to change their ways, too. They have to provide news and entertainment in a greater variety of forms and help advertisers target consumers in the various media. "We are hungry for information and will value those who do a superior job of editing the ocean of material there is," he says.

Several big advertisers are embracing his vision. Over the past 2½ years, Tobaccowala has urged clients, including BMW and Coca-Cola, to cut deals with TiVo and cable companies to create more compelling and targeted messages. GM tried experimental ads on Comcast Corp.'s video-on-demand service in Philadelphia last year. Each month 10,000 people chose to view GM's one- to two-minute ads featuring test-driving segments and in-depth vehicle profiles. Next year, GM plans to roll out slicker ads for most of its vehicles on three more cable systems. "On-demand is going to explode, and we need to be ready for that," says Jack Bowen, GM's general manager for customer relationship marketing.

Other advertisers are experimenting with the most cutting-edge technologies like social networking and podcasting. Earlier this year, Kellogg Co. saw disappointing results from trials of its breakfast cereal Smorz. SMG was able to boost sampling by 500,000 through social networking. Kellogg sent samples and DVDs about the making of cereal and the casting of TV ads to 10,000 influential adolescents.

His ideas may rattle some, but clients and peers pay attention because of Tobaccowala's experience. He has held just about every job at his agency except art director. Before forming Leo Burnett's interactive unit in 1993, he was an account manager, media buyer, and researcher. He joined Leo Burnett in 1982 immediately after earning an MBA from the University of Chicago's Graduate School of Business and an undergraduate degree in mathematics in India.

To stay on top of trends, Tobaccowala reads four daily newspapers: *The Wall Street Journal*, *Financial Times*, *The New York Times*, and the local paper of whatever city he wakes up in. A movie hound, he is addicted to online film trailers. He's also an avid user of RSS, a technology that lets him subscribe to podcasts, blogs, and new sites. He carries an iPod and a Palm Treo.

Tobaccowala does whatever he has to make sure clients don't miss out, either. SMG CEO Jack Klues says he sometimes sends his chief innovation officer specifically to scare a client. "If they are too resistant to try some things we believe is that's a good spot for Rishad," he says. It usually works. SMG has enjoyed the best run of account wins in the business in the past two years, jumping from handling about $9 billion in media budgets to about $14 billion, including taking over the media planning and buying for Coke and GM.

Now Klues has assigned Tobaccowala one of his most challenging tasks to date—restructuring SMG. Despite the performance that has made SMG sought after and Tobaccowala a guru, the futurist says SMG is organized badly and must operate more like a social network than a vertically integrated hierarchy. He wants to infuse SMG with more creative flair, pushing it beyond its media-planning and buying roots. If he does that, the media people may be in charge for good. ■

–By David Kiley in New York

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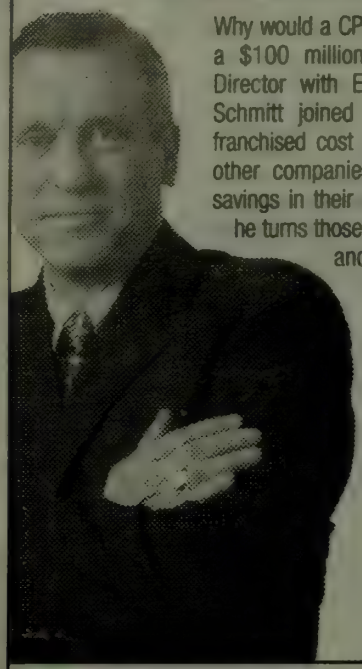
He Gets It.

Jim Schmitt
Managing Director, Expense Reduction Analysts



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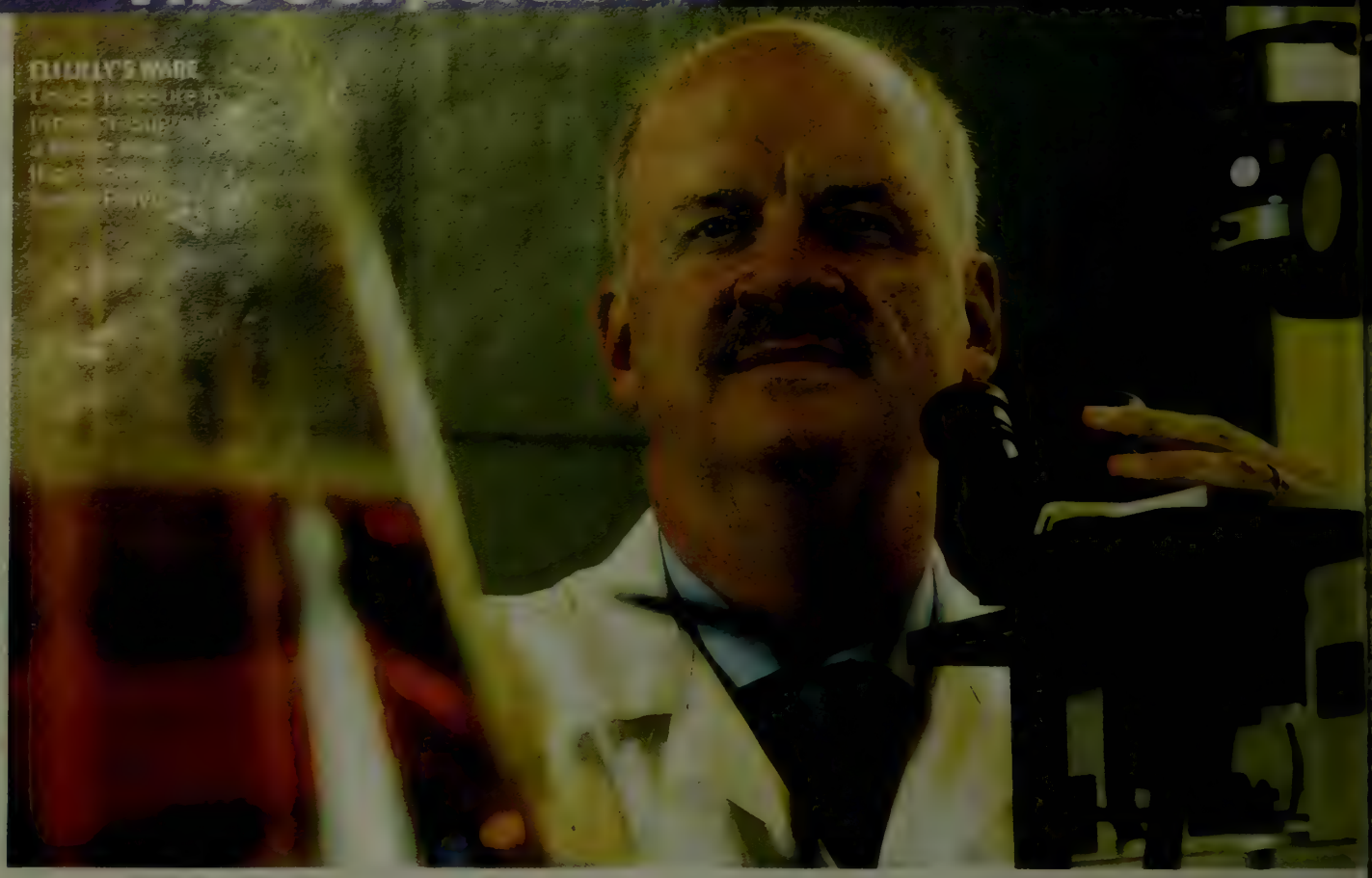


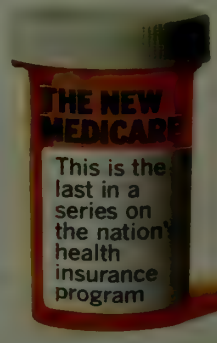
Prescription For Upheaval

How the Medicare drug program is tightening the screws on Big Pharma

IT'S QUITE RARE FOR A PHARMAceutical company to pit its own drug against a rival product to prove its superiority. Never mind that such drug trials can easily cost hundreds of millions of dollars. The bigger risk is that the company sponsoring the trial might find that its drug isn't actually any better than what's already out there. That can mean death at the pharmacy counter.

Nonetheless, it's a risk that Eli Lilly & Co. has decided it needs to take. The company is plowing more than $300 million into a trial designed to determine whether its new anti-clotting drug, called prasugrel, will work better than blockbuster Plavix, which generates $4 billion in sales for Bristol-Myers Squibb Co. If Lilly's drug doesn't win the trial, it'll likely be dead on arrival when it hits the market in 2008. "Lilly is either going to get zero or multibillions" of dollars in sales, says SG Cowen & Co. analyst Stephen M. Scala.

Why would a drugmaker take such an enormous gamble? The answer lies, in part, in a simply named plan that is forcing massive changes across the pharmaceutical industry: Medicare Part D, the new prescription drug program set to launch in January. In essence, the new Medicare plan will lead to survival of the fittest—or at least, survival of the most cost-



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TOUGH SCENARIO

AT FIRST, THE NEW Medicare plan will be a boon to drugmakers' bottom lines. Richard T. Evans, an analyst at Sanford C. Bernstein & Co., expects the Medicare drug benefit to give a 2% to 3% boost to drug company earnings in the first two years of the program. That's because, he figures, insurers will offer plans that cover many brand-name drugs in the early years to attract people to sign up. That will trigger an increase in the use of drugs by seniors with little in the way of price pressure.

But in the long run the betting is that the drug benefit has more downside than upside for the likes of Bristol and Lilly. After the first two years, Evans expects insurer plans to become more restrictive, forcing drug companies to slash prices on products in order to keep them covered. That's why, starting in 2008, he expects the bottom line-boosting dynamic to reverse, and for the program to start cutting earnings by 3% or more annually.

Many drug industry executives agree that the going will only get tougher as the government and private insurers grapple with the mounting cost of the Medicare drug program. There's a much higher hurdle for success now. In the go-go days for drugmakers in the 1990s, the need for them to prove that their drugs were worth the price wasn't so acute. That's because managed-care companies had limited success restricting patient access to—and prescribing by doctors of—new drugs. The result: Drugmakers routinely turned "me too" products into blockbusters. So in a pre-Medicare Part D era, if Lilly's drug was shown to be at least as good as Plavix, the company still would have had a good shot at building a big franchise by using its massive sales force and savvy marketing.

But those days are long gone. Now Lilly feels strong pressure to prove that it has a superior product. The decision sparked some internal debate. Dr. J. Anthony Ware, the trial's leader and vice-president of Lilly's research labs, says some insiders initially warned against trying to prove prasugrel was better than Plavix. They worried that it would be too high a hurdle and argued that the company should just prove that the drugs are comparable.

Overnight, Uncle Sam will become the biggest buyer in the market

However, Ware believed Lilly had no choice. Cheap generic versions of Plavix would hit the market no later than 2011. If prasugrel wasn't shown to be better than Plavix, why would anyone pick it over a generic Plavix? So last summer the group recommended to Lilly Chief Executive Officer Sidney Taurel that the company take Plavix head-on. While acknowledging the risk, Taurel adds that "from what we've seen [in early studies] we are hopeful."

RISKY BET

UNDER ITS 13,000-patient trial, which Lilly is doing in partnership with Japanese pharmaceutical giant Sankyo Co., patients who have a variety of cardiac problems, from unstable angina to a recent heart attack, will be given prasugrel or Plavix. They will then be followed for one year to see which drug better reduced the number of heart attacks, strokes, and deaths. Certainly Plavix has shortcomings—an estimated 20% of patients don't respond well to the drug, according to some cardiologists, for reasons that are not entirely clear. But no one will know until the data are in whether prasugrel has an edge. And because many cardiologists use Plavix at doses higher than that being given in the prasugrel study, Bristol argue that the deck stacked in Lilly's favor.

Bristol executives w speculate on the outcom the prasugrel trial. But point to Plavix as an exan of how they are readying company for the new ag Medicare. Already Bri has published a numbe studies on Plavix that a lyze what the cost-ben tradeoff is for the drug. One recent pa found that for people with certain h problems, the drug, in effect, costs ab $6,300 for every year of life it adds patients. In the world of health-care e nomics, anything below $20,000 is s as a good buy.

That focus on cost-effectiveness now being pushed back into ear stages of product development. Trials new Bristol drugs will not only sh how a drug halts the progression o disease but may also be designed prove how the product affects de rates or hospital stays. Generating t data often involves larger and lon clinical trials, which could put even m upward pressure on drug company search and development budgets.

This approach is a fundamen change in the company's mindset, Bristol execs. Before they had to prov doctors and patients that their dr were valuable. Now they need to pr their cost-effectiveness to big payers well—including those who will be off ing plans on behalf of the federal g ernment. "Companies like ours have been very good at [that]," concedes David Boyko, Bristol's senior vice-pre dent of global medical affairs. Exp that to change fast. ■

–By Amy Barrett in Philadelphia a Michael Arndt in Chicago, with Arl Weintraub in New Y

New Rules of the Game

The growing muscle of Uncle Sam in the drug industry will bring about big changes:

GREATER USE OF GENERICS

Over time, lists of drugs covered by Medicare Part D plans will favor generics. In categories where there are such cheap alternatives to brand-name drugs, "copycat" products that don't offer a big performance edge will become less profitable. That could lead companies to develop fewer of them.

RISKIER CLINICAL TRIALS

Insurers will demand more data to show that a pricey drug is a better choice than a cheaper alternative. That will cause drugmakers to run more head-to-head trials and conduct more studies to give hard proof that a drug saves lives. Such studies can be long and expensive, which raises the stakes for drug companies.

REDRAWING THE SALES MAP

When the Medicare benefit rolls out, some parts of the country will become less attractive for pharmaceutical players based on the ways drugs are covered by insurers offering Medicare plans in those regions. So drugmakers will need to be more flexible about deploying salespeople and marketing dollars.

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McMansions On Wheels

Million-dollar recreational vehicles—and pricey RV resorts in upscale locales—are luring the wealthy. **BY THANE PETERSON**

PAULA AND GEORGE LUTTRELL typically vacation in surroundings as sumptuous as a Four Seasons hotel. There's a big difference, though: Their accommodations are on wheels. The real estate developers from Chattanooga, Tenn., travel around in a 45-foot recreational vehicle that has marble steps, five closets, a queen-size bed, a full-size refrigerator, and front and rear 48-inch plasma TVs. Plus, two motorized "slideouts" expand the living area by as much as 30 inches to 11.5 feet, when the RV is parked. ¶ The Luttrells—she's 37, he's 47—are part of a thriving high-end RV culture. Contrary to RVs' blue-collar i age—and undeterred by soaring gasol prices—a growing number of executi (including Liberty Media CEO John M one), doctors, and other profession prefer to spend their leisure time coaches that sell for $1 million to $2 m lion and have interior appointme reminiscent of old-style Pullman c Many owners also tow "toy haulers" hind their RVs—trailers that carry c his-and-her motorcycles, golf carts, motorized Segways.

These RVers may spend nights campgrounds or Wal-Mart parking l along with the rest of the camper cro But their final destination is often a ga RV resort—complete with spa, ten courts, and pools—in popular vacat spots such as Palm Springs, Ca Hilton Head, S.C.; and Naples, F where per-night rates range from $3 $80. But many RV owners buy lots these resorts so they can park their r for extended stays. At a typical size of feet by 100 feet, this is pricey real est Jim Howell, 75, a retired car dealer fr Carlisle, Pa., paid $84,000 for his lot park near Naples few years ago and it's now worth m than $200,000.

This is an elite gro

COMFORT ZONE Wayne and Rebecca Battle in their Liberty RV

MORE ROOM When parked, this Liberty's sides expand

SLEEP WELL A bedroom in a coach by market leader Newell

v about 325 RVs with million-dollar-price tags are bought annually by pri- individuals, figures Karl Blade, owner ewell Coach, a Miami (Okla.) maker of ry RVs. A smaller number are leased or chased by touring entertainers, CAR drivers, and others. The biggest ers, such as Marathon Coach in urg, Ore., Chicago's Liberty Coach, and vell say sales are holding up this year. as a 200-gallon diesel-fuel fill-up ap- ches $600, smaller players are feeling pinch. Monaco Coach, in Coburg, Ore., ntly decided to close its faltering mil- -dollar RV business.

URE BEATS FLYING

GER TERM, the industry is riding erful trends. Soon well-heeled baby mers will be retiring in droves, while s about terrorism have made flying and seas vacationing less attractive. "Un- fuel is rationed, I don't think it will e much of an effect," says Frank X. igseder, a vice-president at Liberty ch. Sure, luxury RVs get only six to t miles per gallon, but most owners fewer than 10,000 miles on them an- ly. In any case, says Jim Neely, who s Memphis' Interstate Bar-B-Que aurants and drives a Newell RV: "If can't afford to spend a couple thou- l dollars on fuel during a trip, you shouldn't own one."

The million-dollar-plus market is dominated by Newell, which makes 44 custom-built RVs annually, and Prevost (pronounced "pray-vo") conversions, made by 20 or so companies using the shells of European-style tour buses from Quebec's Prevost Car, a Volvo unit. Celebrities who use RVs on tour tend to prefer Prevosts, which have the mechanical guts and suspension of intercity buses and can last a million miles or more.

Private owners have typically been well-heeled retirees. Partial to country music, boating, horse shows, and NASCAR races, "most of 'em made it the hard way," says Liberty owner Sonny Erp, a home developer from Ocala, Fla. That owner profile is changing, though, as RVs get fancier and luxury RV resorts become more prevalent. One exec who's sold on RVs is Liberty Media's Malone, 64. He's usually at the wheel of his Newell when he and his wife, Leslie, 63, travel between their Colorado home and their ranch in New Mexico. "People are intimidated by the size of the things, but they really aren't hard to run," Malone says. The Malones prefer the RV to flying partly because it's easy to travel with their pets—five pugs and a Boston bull terrier.

Making friends is part of the appeal. Companies sponsor owners' clubs that organize tours and rallies, as does an umbrella group with more than 1,000 members called Prevost Prouds. As a result of attending Newell rallies, "many of my best friends are other Newell owners," says Neely. Recently the Luttrells went to a three-day gathering in Kentucky horse country that attracted three dozen Liberty RVs. Their owners took a distillery tour, motorcycled together, and went to a concert by country star Randy Travis, who tours in a Liberty.

The pastime's other big lure is flexibility. "When I was young, my parents had a seaside house, and I hated going to the same place all the time," says Ken Dunsire, 73, a retired Lincoln National executive vice-president. He and his wife, Stephanie, 62, put 20,000 miles a year on their custom-built Featherlite coach. Some people keep their coaches packed with clothes and food so they can take off any time. Wayne and Rebecca Battle, both 71, who own a sawmill in Wadley, Ga., often decide where they're going as they're heading out the driveway. They've ended up as far away as Maine and Las Vegas. "We also have a condo in Daytona [Beach, Fla.]," says Wayne, who drives a Liberty, his fifth. "If I had to give up one, I'd keep the coach." A lot of his fellow luxury RVers would say amen to that. ■

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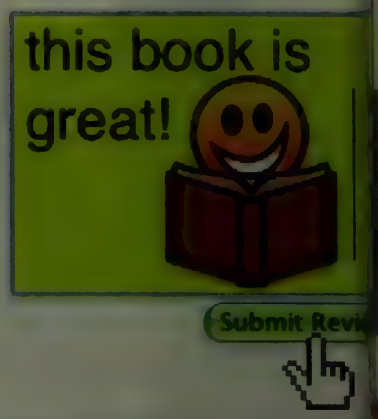

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Powell's, the large Portland (Ore.)-based independent bookstore, lists choices ranging from Oprah to the *Today* show, *USA Today*, and the BBC World Service. Each list is a mixture of highbrow (Virginia Woolf's *Mrs. Dalloway*) and middlebrow (Ken Follett's thriller *Eye of the Needle*)—and all are fun to browse.

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Favorites from bookstore managers
booksense.com

Book Sense, an umbrella organization for independent bookstores, offers monthly recommendations. Its October list ranges from E.L. Doctorow's much-publicized Civil War novel, *The March*, to Mary Roach's examination of theories on the afterlife, *Spook*.

Short story collections
npr.org/templates/story/story.php?storyId=4868008

Nancy Pearl, a Seattle librarian and author of two popular books that offer reading recommendations, describes eight recent collections of short stories. Included are works by such award-winning writers as Lorrie Moore, T.C. Boyle, and Dan Chaon.

CLASSICS

Best Novels of the 20th Century
randomhouse.com/modernlibrary/100bestnovels.html

In 2003, Modern Library (an imprint of Random House) announced its choices for the 100 best novels of the 20th century. The ranking of admittedly highbrow fiction was put together by a panel of writers and editors. Some examples are James Joyce's *Ulysses* (No. 1) and Wallace Stegner's *Angle of Repose* (No. 82). There's also a list compiled from reader suggestions.

Top Nonfiction Titles
randomhouse.com/modernlibrary/100bestnonfiction.html

Modern Library also has a compendium of 100 best nonfiction titles, ranging from *The Education of Henry Adams* (No. 1) to William H. McNeill's *The Rise of the West* (No. 71).

ET CETERA

Corporate Thrillers
www.skokie.lib.il.us/s_read/rd_booklists/finance.html

Writers such as Stephen Frey and Christopher Reich have built a popular following for thrillers situated on Wall Street or in Big Business' corner suites. The Skokie (Ill.) Public Library has a list of somewhat older financial thrillers, most dating from the 1990s. Included are such titles as Michael Crichton's novel of Japanese business intrigue, *Rising Sun*, and Michael Thomas' techno-thriller, *Black Money*.

On Paris
parisvoice.com/?fuseaction=article.main&cat_id=44

Paris Voice, which bills itself as "the magazine for English-speaking Parisians," suggests a range of diverse volumes on the *ville* of Charles Baudelaire and Alain Delon. There's *Paris Tales*, which includes stories from the likes of Colette and Emile Zola, and Edmund White's collection of Paris vignettes, *The Flaneur*.

On the American South
rhodes.edu/NewsCenter/RhodesMagazine/Summer2005/RichTeaching/books-huebner.cfm

The American South has been the setting for shelves of books, from James Agee's *Let Us Now Praise Famous Men* (1939) to Fannie Flagg's *Fried Green Tomatoes at the Whistlestop Café* (1987). Rhodes College offers a selection of five of the greatest of these, from W.J. Cash's 1941 *The Mind of the South* to Anne Moody's 1968 memoir of the civil-rights struggle, *Coming of Age in Mississippi*.

Yesteryear's best-sellers
caderbooks.com/bestintro.html

Consider this catalog of best-sellers of earlier decades, beginning with the 1900s and running through the 1990s. These are fun to peruse for oddities—for example, who remembers Douglas R. Casey's 1980 *Crisis Investing: Opportunities and Profits in the Coming Great Depression*? They may also prompt a re-reading of a book enjoyed years back.

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Numbers That Blow You Away

An unexpected earnings jump often signals big gains ahead. **BY TODDI GUTNE**

EARNINGS SEASON IS about to start on Wall Street, and what investors want to see is some happy surprises. These are profits that come in higher than expected. Many companies have been obliging investors: Over the past 10 years, 59% of companies in the Standard & Poor's 500-stock index beat analyst forecasts, according to Thomson Financial, a research firm. That number shot up to 69% for the second quarter of this year. Still, "a high percentage of these companies beat only by 1¢ or 2¢," says David Dropsey, a Thomson analyst. And the post-announcement gains from those minimal surprises are, well, minimal.

The biggest stock-price gains go to the companies whose numbers blow away estimates. That's to be expected. But perhaps more eye-opening is that many of the biggest surprises came from little-known companies. Amerco, FreightCar America, and King Pharmaceuticals are hardly household names, but they could be among the superachievers in this r porting season (table).

Finding these companies ahead their good news is easier than you m think. "The best predictor of compani that will surprise again are those that su prised in the past," says Russell Lun holm, chairman of the accounting d partment at the University of Michigan Ross School of Business. And those th surprise investors in a big way often so because they are low-profile comp nies with fewer analysts watching the

nd making earnings forecasts. Investing in the big surprisers n be a smart strategy. Lundholm, ong with Jeffrey Doyle at the Uni-ersity of Utah and Mark Soliman Stanford University, studied 0,000 earnings announcements om 1988 to 2000 to measure the ock returns of companies that d large quarterly-earnings sur-ises. They then constructed a rtfolio made up of the top 10% of ose with earning surprises. hen they bought the companies o days after the earnings an-uncement and held the stocks r one year, their portfolio beat the arket by 9%. When the stocks ere held for two years, the portfo-beat the market by a cumulative %. Beyond two years, the size of e earnings surprises decrease ecause more analysts start cover-g the companies, and the esti-ates are less wide-ranging.

With his research in mind, we ked Lundholm to screen for the ggest surprisers of the past quar-r, figuring they're just at the be-nning of a two-year run. We be-n with all U.S.-based companies at trade on the New York Stock xchange, the American Stock Ex-hange, or the NASDAQ. Lundholm reened out stocks with market pitalization of less than $500 million to nsure that the stocks would have some quidity. That narrowed the list from 5,875 1,975. Of those, 651 met expectations ecisely—so he dropped them, too.

Searching for a Nice Surprise

Companies that beat Wall Street estimates of their earnings even in just one quarter often have large stock gains in later years. That's why we searched a database for companies that previously had favorable earnings surprises greater than 1.3% of the share price prior to their last earnings report. Then we zoomed in on the top 1% of the list and cut those surprises that stemmed from one-time events or that weren't likely to be sustained.

COMPANY / SYMBOL	INDUSTRY	PRICE*	QUARTER ENDED JUNE 30, 2005 Estimate	QUARTER ENDED JUNE 30, 2005 Actual	QUARTER ENDED SEPT. 30, 2005 Estimate
Agere Systems AGR	Semiconductors	$10.33	$0.05	$0.24	$0.10
Alpharma ALO	Pharmaceuticals	24.70	0.09	0.39	0.13
Amerco UHAL	Vehicle rental	57.76	2.06	2.57	2.96
Ashland ASH	Chemicals	56.07	2.13	3.09	0.94
FreightCar America RAIL	Railcar manufacturing	41.50	0.29	0.90	0.96
Heidrick & Struggles HSII	Recruiting	32.59	0.38	0.69	0.50
Homestore HOMS	Internet services	4.37	(0.02)	0.02	0.00
Inverness Medical Innov. IMA	Pharmaceuticals	27.01	0.20	0.38	0.10
King Pharmaceuticals KG	Pharmaceuticals	15.17	0.22	0.44	0.32
McDermott Int'l. MDR	Oil services	38.11	0.22	0.43	0.32
Parker Drilling PKD	Oil services	9.39	0.04	0.13	0.06
Safety Insurance Group SAFT	Insurance	36.25	0.97	1.46	1.01
Stewart Info. Services STC	Insurance	51.42	1.16	1.94	1.59
TRW Automotive TRW	Auto parts	29.06	0.37	0.73	0.02
ViroPharma VPHM	Pharmaceuticals	21.05	NA	0.11	0.21

*Oct. 3 NA = Not available

Data: Russell Lundholm, Stephen M. Ross School of Business, University of Michigan, FactSet Research Systems Inc

LICKETY-CLACK

HEN FOR EACH COMPANY that beat the nsensus of analysts' forecasts, Lund-olm calculated the earnings surprise as a ercentage of the company's share price. or example, FreightCar America, a hicago company that manufactures rail-ars, earned 90¢ per share for the quarter nded June 30, trouncing an expected 9¢ profit. The 61¢ earnings surprise was 1% of the company's share price at the nd of the quarter.

Lundholm then ranked the companies p to bottom by the earnings surprise as percentage of stock price. To get the ery best, investors can go to the top 10% f companies. In the interest of space, we ent to the top 1% of companies. Then e examined each to determine if the rong earnings were sustainable or was e product of a one-time event. So we ropped homebuilder WCI Communities, ecause its surprise was from a real estate sale, and satellite-TV provider EchoStar Communications, which got its big boost from a tax credit.

The resulting list is a diverse one, including energy, pharmaceuticals, insurance, management recruiting, and Internet service companies. Among the highlights:

» **Amerco.** The company's name is almost generic, but you'll recognize its big brand: U-Haul. Sure, it's a seasonal business, with more people moving in spring and summer. Still, its earnings have some powerful momentum. More specifically, the company, which emerged from bankruptcy in March, 2004, saw a 51¢ earnings surprise for the second quarter of 2005. Operating margins were up 25%, and revenues rose 4%. Improved technology is helping U-Haul get more use out of its fleet, and strong demand is allowing it to increase rental rates. Better marketing has paid off in higher occupancy rates for the company's self-storage unit.

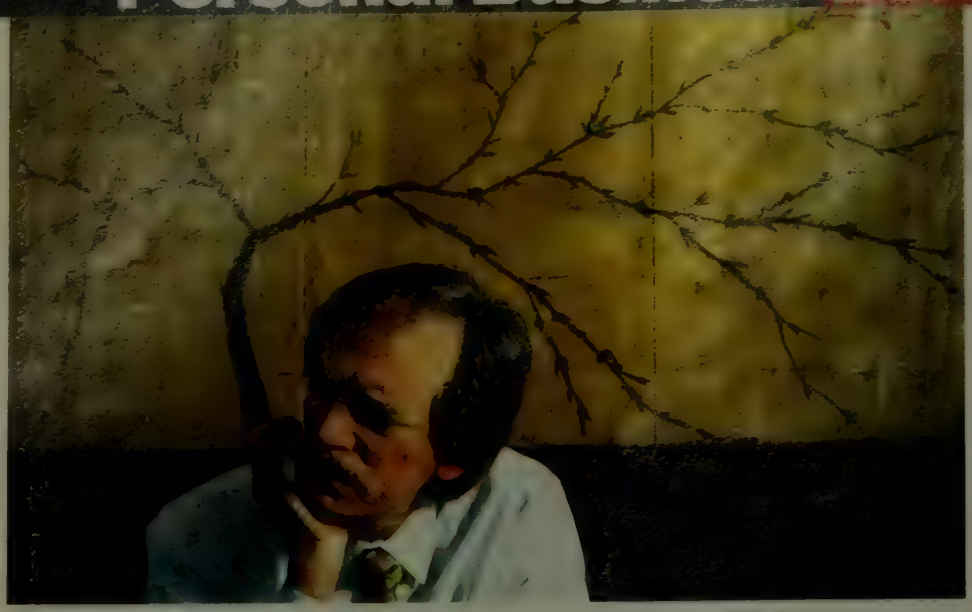
» **King Pharmaceuticals.** A takeover target earlier this year, this maker of branded prescription drugs is starting to look better as a stand-alone enterprise. It turned in a 22¢ surprise for the second quarter. New management is credited with getting inventories under control and with improving the gross margins. Perhaps more important, sales of some products, such as Skelaxin, a muscle relaxant, and Levoxyl, a thyroid-hormone replacement, are proving stronger than expected.

» **Heidrick & Struggles.** In a strong economy, companies turn to headhunters such as Heidrick & Struggles to fill top positions. That's one reason this executive search firm turned in a 31¢-a-share earnings surprise in the second quarter. But more important and long-lasting is that the company is finally undertaking a huge cost-cutting effort. That should help raise the firm's historically low operating margins of 7.3%. The company has typically trailed its competitors' margins by up to 4%.

Of course, there are no assurances that Heidrick or any of the others on the short list—or even those in the top 10%—will continue to be market-beating stocks. But if you are looking for winners, these give you some good odds. ■

BusinessWeek online For an extended list of companies ripe for strong earnings surprises, go to www.businessweek.com/extras

ROBERT NEUBECKER



A Pro Who's Mad for Munis

PIMCO's Bill Gross likes closed-end muni bond funds so much he owns 35 himself. **BY LEWIS BRAHAM**

FROM HIS DESK AT PIMCO'S Newport Beach (Calif.) headquarters, Bill Gross oversees some $500 billion of other people's money—slightly less than the gross domestic product of Thailand. What is this master of the universe doing with his own money? Municipal bonds in general, but closed-end muni bond funds in particular. "I own 35 of these funds personally," says Gross. "You can get a 6% yield on some of these tax-free, compared to just 4% on Treasury bonds. That's a great deal."

It could well be. But Gross's strategy is rife with risk. These funds invest mainly in long-term bonds, and increased tightening by the Fed or a surge in inflation could send prices reeling. That would be especially hard on funds that borrow money to buy additional bonds to juice their yields, a strategy called "leveraging." On top of that, the funds are not cheap. In fact, many trade (closed-end funds are bought and sold like stocks, not like mutual funds) at prices higher than their net asset values (NAV is the market value of a fund's portfolio divided by outstanding shares).

Most analysts who specialize in closed-ends recommend buying only when they trade below their NAVs. "The last time we saw wide discounts on muni funds was at the end of 1999, when no one wanted to own bonds," says Paul Mazzilli, director of exchange-traded fund research at Morgan Stanley. "Today the average discount is only 1.4%, vs. a 3.6% average for the past 10 years." No doubt Gross bought many shares at discounts, but he continues to hold those now at premiums.

To embrace Gross's strategy is to be lieve that the Federal Reserve will soo ease up. "We've already had 15 months o steady increases, which is the averag tightening cycle," says the bond maven He also argues that the rate hikes ar aimed at cooling the overheated housin market, and that's happening.

BUILD A BUY LIST

WHAT IF THE FED continues to hik rates? Higher short-term rates will de stroy the ability of leveraged funds maintain their dividends. "We're alread seeing waves of payout cuts in the funds," says Mazzilli. "And when th funds cut, their shares get whacked."

Mazzilli is wary of most closed-en muni funds, but he does have a few f vorites. Among them is Managed Muni ipals Portfolio, which sells Treasuri short to hedge its munis, and has an 8.4 discount. Two others, Muni Intermedia Duration Fund and Nuveen Quality I come Municipal Fund, are also at dis counts. In contrast, two of Gross's hold ings, BlackRock Municipal Income Trus II and PIMCO Municipal Income Fund both trade at premiums, in part, som speculate, because Gross owns them.

Perhaps the best strategy is to build buy list. Thomas Herzfeld of Thomas Herzfeld Advisors, which invests solely i closed-ends, says they usually get cheap near yearend as investors engage in ta loss selling. While the funds' leverage, fee yield, and holdings are important, the dis count is paramount. "The size of the dis count is about half of our decision-makin process," he says. By that standard abo 10 funds are attractive now. But if you kee your eyes open, discounts should open u on many more. Who knows? By yearen the Fed may be done with its rate hikes and Gross will have been proved right.

Closed-End Muni Bond Funds: High Yields, No Taxes

FUND (SYMBOL)	PRICE	DISCOUNT/PREMIUM*	YIELD
BlackRock Municipal Income Trust II (BLE)	15.78	2.16%	6.4%
Insured Municipal Income Fund (PIF)	13.17	-12.67	5.0
Investment Grade Municipal Income Fund (PPM)	13.44	-14.18	4.9
Managed Municipals Portfolio (MMU)	10.74	-8.44	5.1
Muni Intermediate Duration Fund (MUI)	14.48	-6.04	6.0
Nuveen Quality Income Municipal Fund (NQU)	14.51	-6.45	5.8
PIMCO Municipal Income Fund (PMF)	15.12	1.61	6.5
Van Kampen Municipal Opportunity Trust (VMO)	14.58	-12.90	5.9
Van Kampen Select Sector Municipal Trust (VKL)	12.59	-12.87	5.9
Van Kampen Value Municipal Income Trust (VKV)	13.73	-12.16	5.9

*Difference [illegible] net asset value. All data as of Sept. 30

Data: Closed-End [illegible] ahoo!Finance

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Amsterdam	01-12-2005	Madrid	26-11-2005	Barcelona	06-02-2006
Paris	30-11-2005	Barcelona	28-11-2005	Mexico	07-03-2006
New York	03-12-2005			Monterrey	10-03-2006
Milan	31-01-2006			Santiago	13-03-2006
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Finding Fertile Ground Overseas

Investors can use international real estate to diversify their holdings. **BY ANNE TERGESEN**

IN PURSUIT OF HIGHER RETURNS and lower overall risk, savvy investors seek out alternatives such as commodity or real estate funds. Besides their profit potential, alternatives are prized because they don't generally behave like stocks and bonds. Now a small but growing number of mutual funds are making a new flavor of alternative investment available to individuals—international real estate. It's not a must-have for every portfolio. But if you want to be as diversified as possible, it makes sense to spread your real estate exposure around the globe.

Recently, such powerhouses as Fidelity Investments and real estate specialist Cohen & Steers have launched funds that zoom in on overseas holdings (table). They join the Alpine International Real Estate Equity Fund, which has been investing abroad for more than 15 years. The fund companies are betting that individuals, who increasingly view real estate as a core investment, will see overseas funds as a hedge against any downturn at home. Over the past decade, real estate stocks in different countries have moved in tandem with the global market for listed real estate securities just 40% of the time, vs. an 80% correlation for the global stock and bond markets, says Scott Crowe, a global strategist at UBS. "Local factors drive the real estate markets."

Although foreign properties are not, on the whole, cheaper than their U.S. counterparts, fund managers see good growth prospects abroad. Steve Bulle manager of the Fidelity Internation Real Estate Fund, sees potential annu returns for international property stoc of 7% to 10% over the next decade.

James Corl, Cohen & Steers's chief i vestment officer for real estate securitie thinks there are opportunities in su countries as Japan and Germany, whe banks, utilities, and other conglomerat are divesting properties unrelated to the main businesses. "A lot of that is likely get picked up by firms that specialize real estate," says Corl, whose fund's t picks include Mitsubishi Estate, Japan largest real estate company.

BIG DIVIDENDS

SOME THINK THERE'S more upside f property markets overseas. Since the U led the world out of the 2001 recessio notes Alpine's Sam Lieber, "oth economies' business cycles have mo room to run."

One difference between dome tic and foreign real esta funds is the yield they offe U.S. funds hold mainly real e tate investment trusts, whic avoid corporate taxes b passing along big div dends to investors. B REITs are new in son countries and don't exist others. As a result, in ma overseas markets, real estate held mainly by operating comp nies, which make lower payout Still, with more countries recently lowing REIT-like structures, foreign R ITs are likely to become more prevalent.

The funds are not making big bets o single countries. For example, the Cohen Steers International Realty Fund has 20 of its assets in Britain, 15% in Hong Kon 13% in Australia, and 10% in Japan. T holdings are Land Securities, a British o fice and retail property owner, and Wes field Group, an Australian mall own that's expanding in Europe. Alpine favo J.M., a large Swedish developer, and Spa ish builder Fadesa Inmobiliari

To replicate the global ma ket, you'd have to devote abo half of your real estate alloc tion to international holding But given the risks in foreig investments—notably, curre cy fluctuations—some i vestors might opt for less. Sti even a little exposure to th diversifying asset shoul help cushion your retur over time. ■

Buy into Buildings Abroad

FUND (SYMBOL)	YEAR-TO-DATE TOTAL RETURN*	EXPENSE RATIO
AIM Global Real Estate (AGREX)	10.7%	1.40%**
Alpine Intl. Real Estate Equity (EGLRX)	14.5	1.35
Cohen & Steers International Realty (IRFAX)	10.57	1.70
Fidelity International Real Estate (FIREX)	7.58	1.25
ING Global Real Estate (IGLAX)	8.35	1.75**

*Appreciation plus reinvestment of d[illegible] and capital [illegible] before taxes, Jan. 1–Sept. 30, 2005
**Does not include initial sales charges [illegible] AGREX, 5.75% IGLAX, and 4.75% (IRFAX)

Data: BusinessWeek, Morningstar Inc.

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EDITED BY TODDI GUTNER

BENEFITS

WHY THE ROTH 401(k) IS A 'DUD' SO FAR

UNLESS YOUR RETIREMENT plan is managed by **Vanguard Group,** don't expect to see the Roth 401(k) pop up as an option in your benefits package yet. "It has turned out to be a dud," says Michael Weddell, a retirement consultant at Watson Wyatt in Southfield, Mich. "Most employers are not offering them right now."

Roth 401(k)s are taxed differently than traditional plans. When you put money into a conventional 401(k), you reduce your taxable income, but you must pay regular income tax when you take distributions. Participants in a Roth 401(k) pay their taxes up front.

Many benefits consultants thought Roth 401(k)s would be rolled out in January, yet companies are waiting for the **Internal Revenue Service** to clear up some murky tax rules—such as how early withdrawals will be taxed. "There has been no guidance, that's true," says IRS spokesman Bruce Friedland. "The IRS intends to issue guidelines this fall." Vanguard spokesman John Demming said the firm has been talking to corporate clients and studying the Roth 401(k) for more than a year. "We are prepared for the decisions the IRS makes and are ready to offer it on Jan. 1," he says. *–Lauren Young*

RETIREMENT

Patience Pays Off

TIME IS THE INVESTOR'S friend. The truth of this Wall Street adage is reinforced by t latest research on millions of 401(k) participants by the Employee Benefit Researc Institute and the **Investment Company Institute,** a mutual fund industry group. They delved into their vast database to focus on those who participated in their compan 401(k) plans for the five years ended in 2004—about 4 million people. Although th period included a nasty bear market, the average account balance rose by 36%, fro $67,016 to $91,042. The gains came from contributions and investment returns.

The findings should assuage concerns that Americans aren't preparing for retirement. Maybe it was inertia, but 401(k) owners never fled stocks or abandone their long-term goals. At the end of 2004, 67% of the average portfolio was invest in equities (46% in stock funds, 15% in company shares, and the equity portion of the 10% in balanced funds). Among other findings: Life cycle funds are increasing popular, especially with younger participants. These funds make it easy to get a portfolio appropriate for their age and tolerance for risk. *–Christopher Far*

TIME OFF

LOUIS COMFORT TIFFANY'S glass has inspired millions of stained glass knockoffs. But many people have never seen the real thing. The Seattle Art Museum (seattleartmuseum.org) will showcase more than 120 Tiffany vases, window panels (such as *The Reader*, shown here), lamps, and mosaics in the first broad exhibit of the artist's work since the late 1980s. Many of the pieces, which also include metalwork and furniture, have never been publicly exhibited before. The show will run from Oct. 13 to Jan. 4, then moves to Toledo, Dallas, and Pittsburgh. *–Kristina Shevory*

(TOP) KEN ORVIDAS; (TIFFANY) RICHARD GOODBODY/COURTESY OF THE NEUSTADT MUSEUM OF TIFFANY ART, NEW YORK

LEISURE

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BY GENE G. MARCIAL

DEMAND FOR LIQUEFIED NATURAL GAS IS LIFTING CHENIERE.

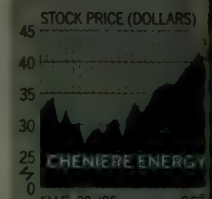
BLUE NILE'S DIAMOND BIZ MAY GET A PROPOSAL FROM AMAZON

WILL A NEW PULMONARY DRUG LEAD TO A BUYOUT AT ENCYSIVE

Buoyant at Cheniere

AS OIL PRICES spurt up, liquefied natural gas will probably take a growing share of the energy market in the years ahead. So say some pros now investing in LNG. The only U.S. pure play is Houston's Cheniere Energy, whose shares trade on the American Stock Exchange with the ticker symbol LNG. Cheniere is currently building three "regasification" terminals in Louisiana and Texas, with the capacity to transform cheap imported LNG back to natural gas. Chevron and Total have already contracted with Cheniere to treat LNG that they will buy abroad when these terminals start operations in 2008. A fourth Cheniere facility is still awaiting government approval. Cheniere shares have soared—from 25 in May to 39 now. William Harnisch, CEO of hedge fund Peconic Partners, which owns a 1.5% stake and invests heavily in energy, says Cheniere is "way ahead of the curve in gearing up for the jump in demand for liquefied natural gas in the years ahead." He figures the shares will hit 100 in two years, in light of projected revenues and earnings before interest and taxes. His forecast, however, is based on natural gas priced at a conservative $4 per 1,000 cubic feet, vs. today's perhaps unsustainable $14. Samuel Brothwell of Wachovia Securities, who rates Cheniere "outperform," says "LNG is essential to keep pace with the fast rise in demand for gas." He sees Cheniere making money in 2008. Phillips Johnston of JPMorgan Securities, which has done banking for Cheniere, rates the stock "overweight." He sees Cheniere earning 84¢ a share and having cash flow of $2.26 a share in 2008. Johnston predicts that "imports of LNG will expand substantially in the coming 10 to 15 years.

FLOATING HIGHER



Data: Bloomberg Financial Mark

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lue Nile: A Fit for Amazon

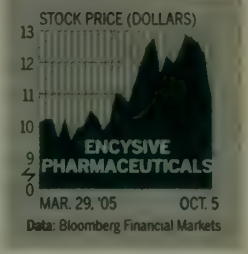
OUR MONTHS AGO, Scott Devitt of Legg Mason Wood Walker downgraded online diamond retailer Blue Nile (NILE) from "buy" to "hold" partly because of slow er growth—and because venture italists still owned 15% of the stock. Oct. 3 he raised it back to "buy." y? Orders have picked up—to above —and the VCs have moved on. And, report, Devitt said that Nile would perfect fit for Amazon.com, which sells diamonds. That lifted the k from 32 to 35 in a day. It is now at "It's rare that we'd recommend an uisition for Amazon," says Devitt, Nile is a unique example of a cal buy for Amazon. Nile's business del is akin to Amazon's, which focuses on inefficient kets, he notes. His target for the stock is 40. Fidelity estments owns 15%, and Morgan Stanley 9.5%. Devitt ects earnings of 75¢ in 2005 and $1 in 2006, vs. 2004's . Nile CEO Mark Vadon declined comment. Amazon kesperson Jani Strand declined comment.

A BRIGHT GLEAM

ncysive Is Breathing Easy

AMONG BIOTECHS favored by Mark Monane of investment firm Needham, Encysive Pharmaceuticals (ENCY) may be an early winner for two reasons: Its oral drug, Thelin, for pulmonary arterial hypertension, or high blood pressure in the lung, may get Food & Drug Administration approval early next year. And Monane sees the company as an attractive buyout. Thelin, Encysive's lead product, has shown good results in recent clinical trials, notes Monane, who rates the stock a strong buy. It has been winging up, from 9 in May to 13 in September, before easing to 11 on profit taking. Monane figures the stock will hit 17, based on his forecast that Encysive will start making money in 2007—with earnings of 99¢ a share, jumping to $2.20 in 2008. He expects its projected sales of $127 million in 2007 to leap to $217 million in 2008. Monane says Encysive doesn't plan to take on a partner to develop and market Thelin. Without a large drugmaker as a partner, Encysive would be vulnerable to big drugmakers looking to land a prize like Thelin—which, he figures, has a potential market of $1 billion. The total market for pulmonary hypertension drugs could be far greater. Patrick Flanigan III of investment bank WR Hambrecht, who rates the stock a buy, says Thelin is the best drug of its kind. In the short run, he figures sales for the treatment of pulmonary hypertension could soar—from $367 million in 2004 to $833 million in 2009. Flanigan expects Thelin will capture 35% of the market by 2009. ■

WINGING UP



BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

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Personal Business Figures of the Week

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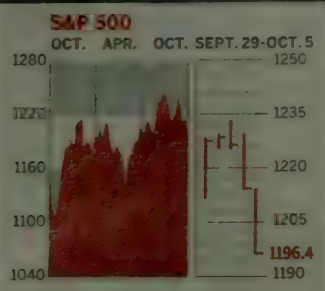


COMMENTARY

The interplay of inflation and higher oil prices spooked stocks to start the final quarter of the year. The prospect of simultaneously slower growth and higher inflation gained currency this week as a result of downbeat business readings and the bearish views on rate hikes of two Federal Reserve officials. Boston Scientific and eBay were among the week's few winners.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	OCT. 5	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1196.4	[illegible]	-1.3	5.5
Dow Jones Industrials	10,317.4	[illegible]	-4.3	1.4
NASDAQ Composite	2103.0	[illegible]	-3.3	7.5
S&P MidCap 400	696.2	[illegible]	5.0	15.6
S&P SmallCap 600	328.4	[illegible]	2.9	13.4
DJ Wilshire 5000	11,956.3	-1.5	0.0	7.8

SECTORS	OCT. 5	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
BusinessWeek 50*	723.3	-3.3	2.6	9.7
BW Info Tech 100**	361.9	-0.5	-3.0	6.6
S&P/BARRA Growth	572.2	-1.7	-1.7	4.4
S&P/BARRA Value	620.0	-1.7	-0.9	6.5
S&P Energy	374.8	-8.1	29.8	32.5
S&P Financials	389.9	-0.4	-5.2	0.6
S&P REIT	147.9	-0.7	2.4	13.7
S&P Transportation	216.9	-1.4	-10.2	2.1
S&P Utilities	164.4	-2.7	16.1	27.3
GSTI Internet	175.7	1.0	-1.5	14.1
PSE Technology	800.1	-0.4	2.7	14.3

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	OCT. 5	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST MONTH
S&P Euro Plus (U.S. Dollar)	1453.9	0.2	4.1	19
London (FT-SE 100)	5427.8	-1.2	12.7	15
Paris (CAC 40)	4594.1	-0.1	20.2	21
Frankfurt (DAX)	5069.4	0.4	19.1	25
Tokyo (NIKKEI 225)	13,689.9	1.9	10.2	21
Hong Kong (Hang Seng)	15,161.0	-0.4	5.5	13
Toronto (S&P/TSX Composite)	10,748.1	-2.7	16.2	22
Mexico City (IPC)	15,720.4	-0.9	21.7	41

FUNDAMENTALS	OCT. 4	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	2.05%	2.05%	1.69
S&P 500 P/E Ratio (Trailing 12 mos.)	18.9	19.0	19.5
S&P 500 P/E Ratio (Next 12 mos.)*	14.4	14.9	15.2
First Call Earnings Surprise*	10.49%	3.82%	2.21

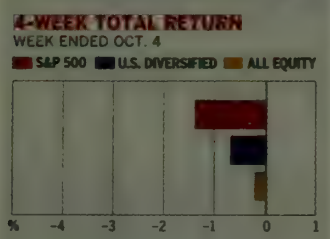
*First Call Co.

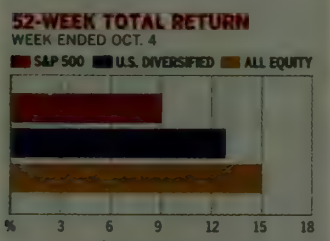
TECHNICAL INDICATORS	OCT. 4	WEEK AGO	READ
S&P 500 200-day average	1200.1	1199.6	Negati
Stocks above 200-day average	59.0%	57.0%	Neutr
Options: Put/call ratio	0.73	0.85	Positi
Insiders: Vickers NYSE Sell/buy ratio	4.33	4.94	Negati

BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Divsfd. Metals & Mining	11.8	Oil & Gas Refining	100.5
Airlines	11.1	Managed Health Care	64.6
Gold Mining	10.6	Oil & Gas Exploration	55.8
Insurance Brokers	6.0	Fertilizers & Ag. Chems.	58.5
Railroads	5.9	Health-Care Distrbtrs.	52.4

WORST-PERFORMING GROUPS	LAST MONTH %		LAST MONTH
Educational Services	-19.3	IT Consulting	-3
Home Furnishings	-19.0	Automobiles	-32
Aluminum	-14.8	Aluminum	-3
Specialized Cnsmr. Serv.	-12.2	Photographic Products	-3
Tires & Rubber	-11.6	Home Furnishings	-3

MUTUAL FUNDS





Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Precious Metals	9.4	Latin America	69.0
Latin America	[illegible]	Natural Resources	45.1
Diversified Emerg. Mkts.	5.9	Diversified Emerg. Mkts.	40.6
Japan	5.6	Utilities	31.6
LAGGARDS		**LAGGARDS**	
Real Estate	-2.9	Financial	[illegible]
Financial	-1.8	Domestic Hybrid	8.0
Large-cap Value	-1.2	Large-cap Blend	9.3
Large-cap Blend	-1.1	Miscellaneous	10.3

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
ProFunds Precs. Mtls. Inv.	17.5	T. Rowe Price Emg. Europe	78.2
ProFunds Ultra Japan Inv.	16.4	Guinness Atkn. Gl. Energy	76.7
ING Russia A	15.3	T. Rowe Price Lat. Am.	75.1
Midas	12.8	iShares S&P L. Am. 40 Idx.	74.3
LAGGARDS		**LAGGARDS**	
American Heritage Growth	-16.7	Ameritor Investment	-54.2
Munder RI. Est. Eq. Invt. A	-9.4	ProFds. USh. Mid Cap Inv.	-29.4
Rydex Weakening Dollar H	-7.5	American Heritage Growth	-28.6
ProFds. Mble. Tlcmms. Inv.	-7.1	ProFds. USh. Sm. Cap Inv.	-24.5

INTEREST RATES

KEY RATES	OCT. 5	WEEK AGO	YEAR AGO
Money Market Funds	3.25%	3.21%	1.2
90-Day Treasury Bills	3.55	3.46	1.71
2-Year Treasury Notes	4.18	4.06	2.6
10-Year Treasury Notes	4.34	4.26	4.1
30-Year Treasury Bonds	4.57	4.50	4.8
30-Year Fixed Mortgage †	5.94	5.84	5.72

†BanxQuote.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.79%	4.4
Taxable Equivalent	5.41	6.3
Insured Revenue Bonds	3.93	4.6
Taxable Equivalent	5.61	6.57

THE WEEK AHEAD

INTERNATIONAL TRADE *Thursday, Oct. 13, 8:30 a.m. EDT* » The August foreign trade deficit probably widened to $59.5 billion. That's the median forecast of economists surveyed by Action Economics. The July trade gap was $57.9 billion.

RETAIL SALES *Friday, Oct. 14, 8:30 a.m. EDT* » Retail sales are forecast to have rebounded with a 0.3% gain in September. A slowdown in vehicle sales led to a 2.1% fall in August retail sales. Even excluding vehicles, retail sales very likely grew 0.3%, after a 1% rise in the previous month.

CONSUMER PRICE INDEX *Friday, Oct. 14, 8:30 a.m. EDT* » Consumer prices for goods and services most likely jumped 0.7% in September, following a 0.5% gain during August. Stripping out energy and food, consumer prices probably rose 0.3%, after edging up 0.1% in August.

INDUSTRIAL PRODUCTION *Friday, Oct. 14, 9:15 a.m. EDT* » September factory output probably contracted 0.2%, after a 0.1% gain in August. As a result, the average monthly operating rate probably fell to 79.5%, from 79.8% in August.

BUSINESS INVENTORIES *Friday, Oct. 14, 10 a.m. EDT* » August inventory levels are expected to have grown 0.5%, offsetting the 0.5% decline in July.

The *BusinessWeek* production ind rose to 256.7 for the week end Sept. 24 and stood 12.3% above t year-ago level. Before calculation the four-week moving average, t index eased to 253.4.

BusinessWeek onlin

For the BW50, more investmen data, and the components of the production index visit www.businessweek.com/extras

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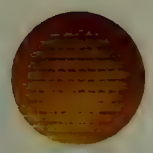

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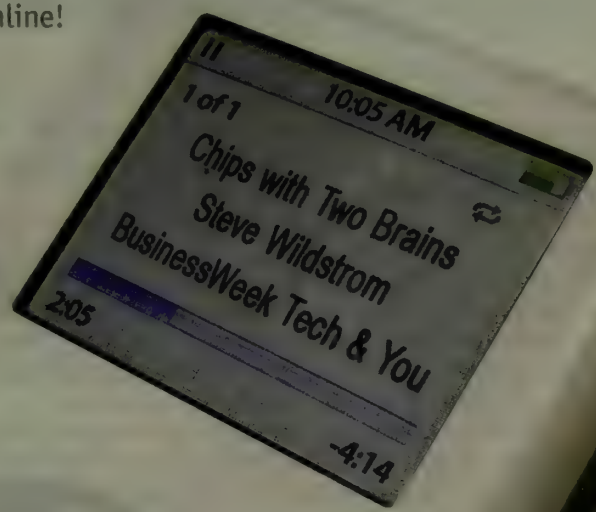

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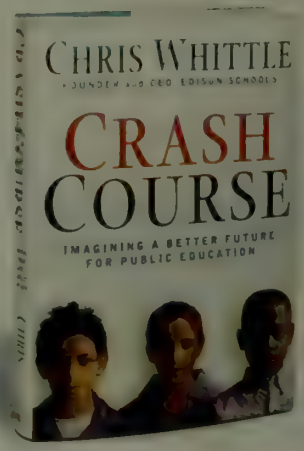
It's Teacher Salaries, Stupid

CRASH COURSE Imagining a Better Future for Public Education
By Chris Whittle; Riverhead Books; 269pp; $24.95

Like many other educators, Chris Whittle, the controversial chief executive of Edison Schools, believes the No Child Left Behind law is heading for a "train wreck." The law mandates that all U.S. schoolchildren must meet state proficiency standards in math and reading by 2014. During an interview held in Edison's New York offices, Whittle told this reviewer that as the law's performance bar is raised, "thousands of schools, with 15 million students," will fail to make the grade.

Crash Course is a provocative look at the radical reforms that Whittle—who runs the largest private company managing public schools—believes are needed if there's to be any hope of reaching the law's lofty goals. To remedy the dire shortage of qualified personnel, for instance, he calls for performance-based pay that would give the best teachers up to $130,000 a year and the best principals up to $200,000. He would scrap the rigid schedules that have governed the school day for decades in favor of giving students far more independent study. And he would vastly increase investment in educational research and development.



Business readers might tend to dismiss everything Whittle has to say because of Edison's smudged track record. He took his company public in 1999 with promises of big profits to come in the business of running public schools. But over the next four years, the red ink never stopped flowing. In late 2003, Whittle finally threw in the towel, taking Edison private in a deal that paid shareholders just 10¢ on the dollar of the initial-public-offering price.

He has little comment about this financial history in *Crash Course*. That's too bad, because a full accounting of Edison's odyssey would have been both fascinating and instructive.

Still, after some 15 years at Edison spent trying to improve public schools, Whittle is well worth listening to as an educator. Although Edison has vanished from the radar since going private, it operates what amounts to one of the nation's largest school systems, with 70,000 students at 157 sites. Most are rough schools, with a majority of students from low-income, minority families. In Philadelphia, for instance, Pennsylvania entrusted Edison with 20 abysmal institutions. At the very best of these, a staggering 88% of students were failing the state's math exam. But as Tom Ridge, who was the state's governor during part of this period, writes in the book's forward, "the results have been extraordinary." Last year, Ridge notes, achievement scores in schools managed b Edison jumped 10.5 percentage points—10 times the gain they enjoyed before the company took charge.

Few would disagree with Whittle's assertion that schools need to adopt a "100% guarantee"—meaning, for instance, that by the third grade, 99.9% of students would be reading well. To deliver on that guarantee, he argues that we need to double the average teacher salary, to $90,000. That may sound like fantasy, but does anyone think we can catch up with other nations while we have a national shortfall of 250,000 qualified math and science teachers? It's a good be Whittle's performance-based pay would help close that gap

The biggest surprise in this book is that Whittle, unlike many liberals, doesn't call for massive tax increases to pay fo such reforms. Instead, he advocates a sea change in how we spend the billions that schools already get. Thus to pay for doubling teacher salaries, he would cu the number of teachers by up to one-half. But he wouldn't do that by doubling class sizes. Rather, beginning in about the fourth grade, Whittle would greatly increase the amount of time students spend in independent study. By high school, students would be spending about half th day studying on their own.

Students would also be given a big role in running schools. The best pupils would help tut younger ones. And all would have the chance to work at such jobs as fixing computers, answerin phones, and monitoring study halls. If all studen worked just three hours a week, Whittle argues, would be far easier to get by with fewer teachers and staff.

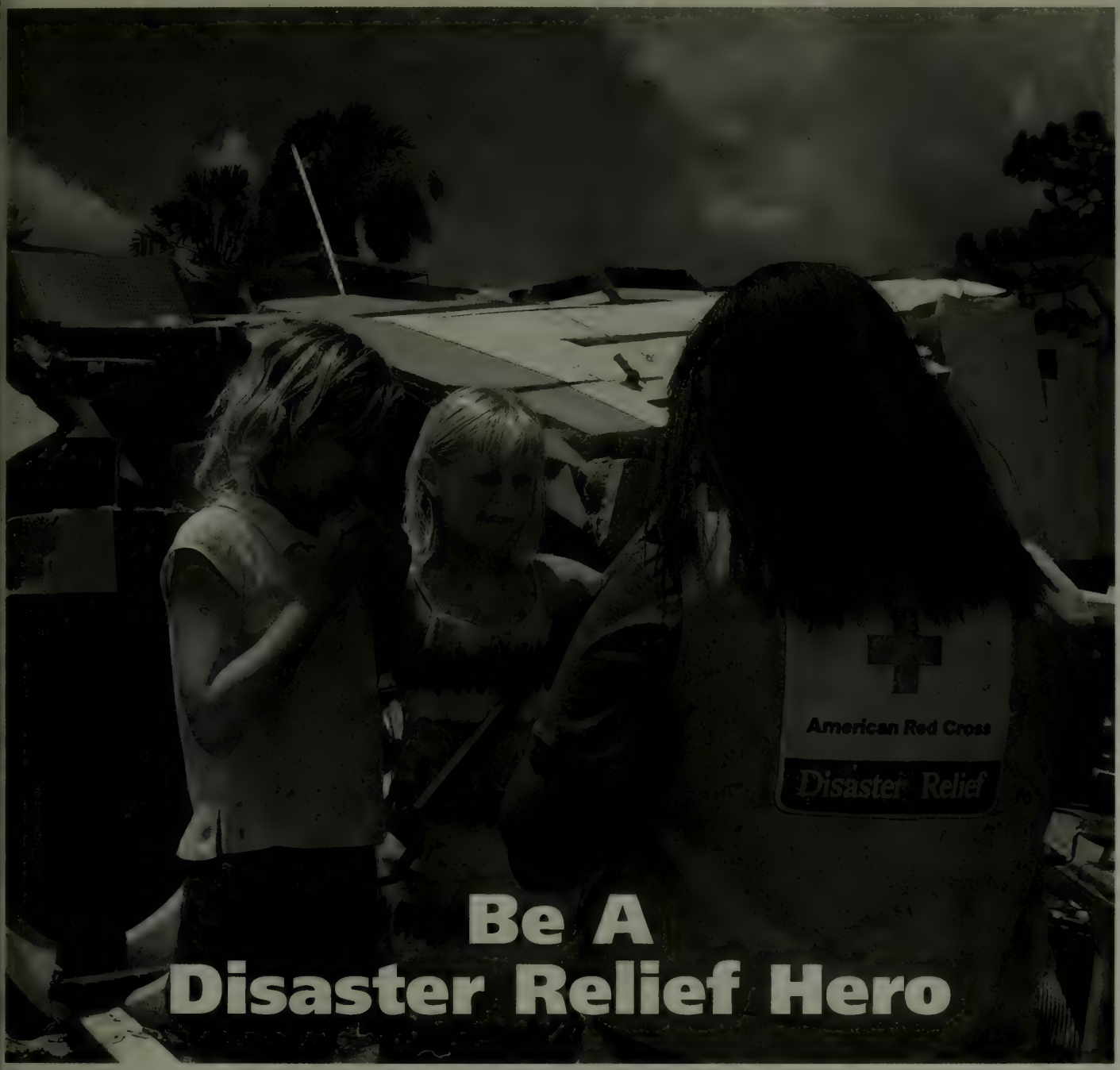
Whittle has a blackboard full of new strategies for doubling school pay

Whittle reports that the nation is spending only $260 million a year on education R&D—a pittance compared wi federal largesse on research fo defense and health. He favors gradually raising that to $4 billion a year and using the funds to develop more effectiv systems for managing schools

There are many other intriguing ideas here, includir the need for instruction on career choices, consumer financ and health. Few will agree with everything Whittle has to sa But the book should stimulate bold thinking among readers and policymakers—something we require if we're ever goin to create public schools that truly leave no child behind. ■

–By William C. Symon

BusinessWeek online For an interview with Chris Whittle, go to www.businessweek.com/extras



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Victims of the recent hurricane need help immediately. The **American Red Cross** is on the scene—providing shelter, food and counseling. But your help is urgently needed. Your contribution will help the victims of the recent hurricane and thousands of other disasters across the country each year.

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Together, we can save a life

BY ROBERT KUTTNER

An Economic Storm Surge

What will be the net impact of Hurricane Katrina on the economy? That question is trickier than it seems. The terror attacks of September 11 did less long-term economic damage than first predicted, in part because the Federal Reserve was induced to keep interest rates very low for nearly three years. But in Katrina's case, the opposite could happen. Katrina's direct and indirect economic costs are likely to be underestimated and the Fed is compounding the damage by hiking rates.

Katrina brought an added jolt to energy prices that were already rising due to tight supplies of natural gas and oil products and heated demand from China and India. With oil refineries running at more than 96% of capacity, it didn't take much damage to cause gasoline price spikes that will last for months. But consumers also will soon face home heating and electricity bills at least one-third higher than last year's. And that's on top of stubbornly high fuel prices that hit not just private autos but trucks, buses, and airlines. With three-fourths of all goods moved by truck or plane, higher fuel costs will cycle into higher consumer prices across the board.

Additional indirect costs will include insurance industry losses and higher property insurance rates, a run on some building materials, and higher shipping costs for agricultural products that normally use the Mississippi River and the now ruined Port of New Orleans. All these higher prices will function like a tax on purchasing power.

UNFORTUNATELY, THE FED is not behaving as wisely as it did after September 11. Then, central bankers erred on the side of cheap money, keeping short-term interest rates at 50-year lows and flooding the system with liquidity. Even so, the average person didn't benefit much from the resulting recovery. Real median earnings of nonsupervisory workers are where they were four years ago.

Today's economy is not all that robust to begin with. But this time, the Fed has wrongly ruled in favor of tight money. Why aren't Greenspan & Co. cutting the economy some slack? Apparently the rush of new federal spending on Katrina relief and recovery has alarmed the central bankers. So instead of cueing an end to their recent trend of relentless rate hikes, Fed governors evidently reasoned that all this added fiscal stimulus required an offsetting rate hike. On Sept. 20, with New Orleans still under water, the Open Market Committee ordered yet another quarter-point rate hike—the 11th in a row, raising the federal funds rate to 3.75%.

Yet here is a case where inflation statistics are entirely misleading as economic indicators. The consumer price index will likely rise in coming months, as higher energy, transportation, and borrowing costs work their way throug the economy. But these price increases are signs of econom weakness, not the type of overheating that sometimes justif higher rates. The result of this misguided inflation vigilanc The Fed is leaning against growth, just as growth is falterin due to the hurricane's big hit to purchasing power.

At a deeper level, Katrina increases the stress on the core weakness of the American economy—its ever-greater relian on foreign borrowing. The U.S. has a dangerous and escalating co-dependency with Asia, most notably China a Japan. They keep lending us dollars to cover our huge trade imbalances and our absence of net domestic savings. We ke using those dollars to keep buying their products. No serious observer thinks this gam can go on forever. It's only a question of what event triggers a break, and perhaps a dollar crash. Katrina, whose short-term recovery cos will increase the federal deficit by at least $20 billion and cause America to borrow even mo from abroad, intensifies the strain.

> The Fed, hiking rates, underplays the economic cost of Katrina

Not one of these problems has a short-term cure. True energy independence is a long-term project, which the Bush Administration is fail to take seriously. Restoring fiscal balance will take time and political leadership, yet the Administration is persisting with its program tax cuts—worsening deficits. Reversing the structural trade imbalance and its huge foreign borrowing could be partly achieved by better fiscal policies, partly by more symmetric trade rules. But little progress is in sight. Protecting our cit from the escalating risk of global warming and flooding wi require a shift in energy consumption policies as well as la outlays for public infrastructure. Here again, there's little awareness at the White House, and less leadership.

For now, the economic costs of Katrina are a slow drip. I markets get panicky—and they have reason to—the costs could turn into a major flood. ■

Robert Kuttner is *co-editor of* The American Prospect *and author of* Everything for Sale

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INTERVIEW WITH HASSO PLATTNER

To Innovate, Collaborate

Hasso Plattner, co-founder of SAP, the German business-process software giant, announced on Oct. 3 that he will donate $35 million to fund a desig school at Stanford University. It will be called the Hasso Plattner Institute of Design. David Kelley, founder of IDEO in Palo Alto, Calif., and a Stanfor engineering professor, led the drive to create this radically new enterprise.

The Institute of Design will teach multidisciplinary innovation and design strategy by bringing together students from business, engineering, medicine, management, the social sciences, and design to form teams to solve problems. Plattner talked to Assistant Managing Editor Bruce Nussbaum about the importance of design, the reason for his gift, and his hopes for the new school. Here are excerpts of their conversation:

Many disciplines together distill the best ideas, says Plattner

What do you expect from the new design school?
I started my career at IBM as an electrical engineer, and I learned in the field that you have to be broader than you thought. You have to work with people. You have to learn to listen. When you study, all the work you do is within your own faculty. You become a specialist. It's common that computer scientists are relatively introverted. It's important for people to learn to work together with other disciplines.

Stanford has already proved that students coming from the medical school, the business school, design, engineering, and psychology, working together for six to nine months on projects, are able to move things forward beyond what any of them could have done within their own faculty.

How did you connect with David Kelley?
Probably through your magazine. More than a year ago, when we had our customer meeting in New Orleans, I gave a keynote speech with regard to development, early prototyping, and how we want to do software design in the future. On the way to the address I got a copy of your magazine with IDEO on the front (BW–May 17, 2004: *The Power of Design*). I just had five minutes to flip through. Many of the ideas talked about were so commonsense, but they work. I went up to the stage, showed the magazine, and said: "There is a company doing exactly what I think we should do." When I came back to the Bay Area, I looked the company up.

Why did your foundation choose Stanford?
I set up shop in the Bay Area 12 years ago to promote more innovation inside SAP. Stanford has played a big role by creating an innovative atmosphere in that area. It helped us tremendously. I wanted to contribute to Stanford but didn't want to just give money. I wan to have the pleasure of seeing something grov Then we found this project.

How are you generating innovation inside SAP
We worked with [design] firms in the past. Bu was mostly scratching the surface. IDEO was different. They weren't doing much in softwa they were mostly in devices in the physical world. But they were doing a lot with users.

We started a project. We came up with the idea for a desig consulting team inside the company focusing not just on the latest stage of how we should present something, but analyz the whole process of how users work. Now we do a deep dive We do research. What are other people doing? What's curre thinking at 20 universities? What's the competition doing? T to people who use competitive software products. Then prototype what you have learned and what you want to prov and discuss this again and again. We found that this process can be repeated (across different businesses).

So SAP has an internal design consulting team?
Yes, and its success is pretty amazing. It works on real projects—and without clashing with the egos of the software developers. An internal consulting team can be efficient whe it's not in the middle of an operational division. I think man companies will go that way in the future: have design consu ing teams internally that work with actual development tear

What do you see for the future of innovation?
Innovation will take place between disciplines so that, for ex ample, new medical devices will come out of computer scier and mechanical engineering. If we start educating our kids i this direction, and we increase innovation, then we can give away some of our manufacturing to other places in the worl

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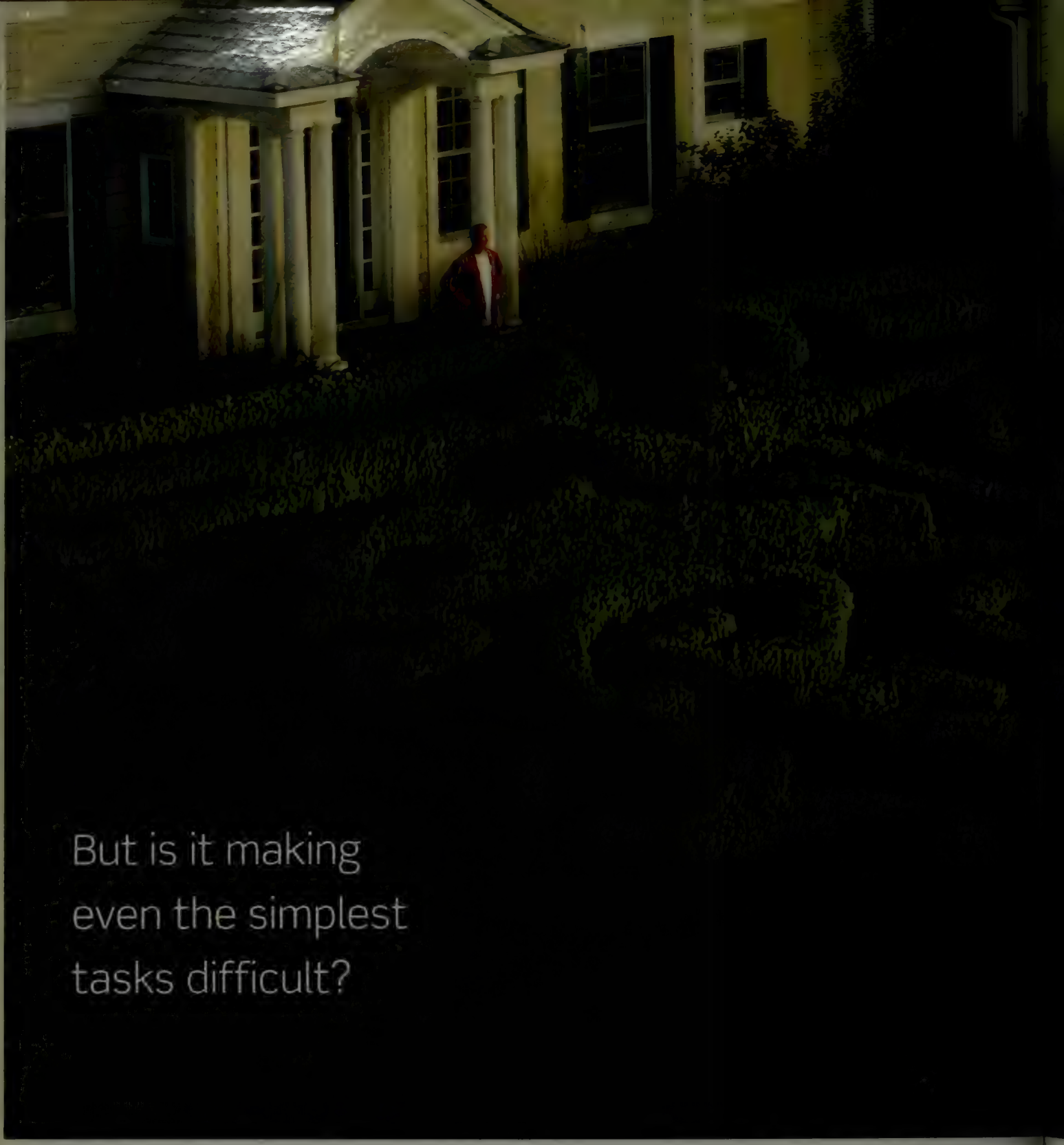

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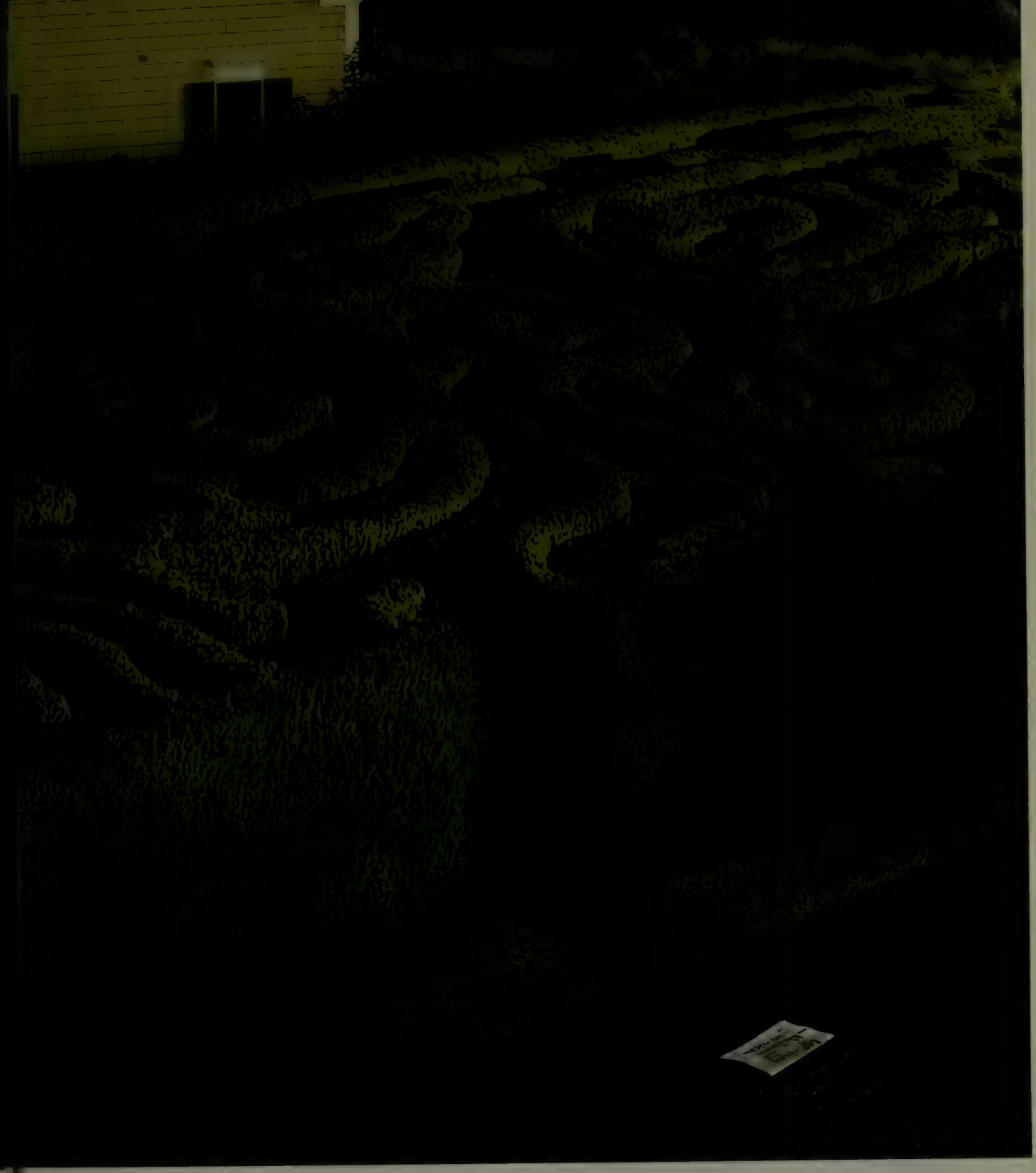
even the simplest
tasks difficult?



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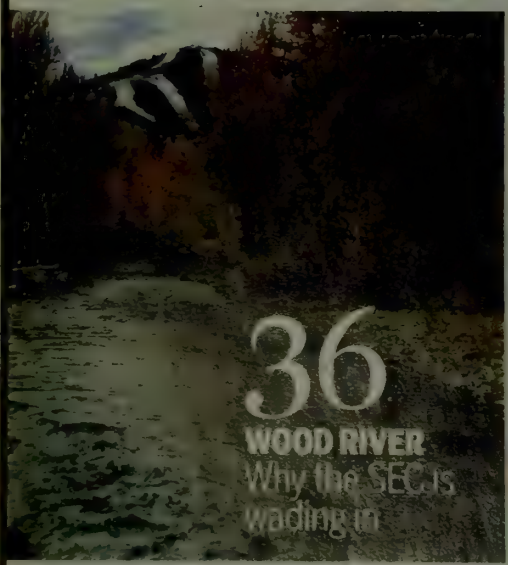

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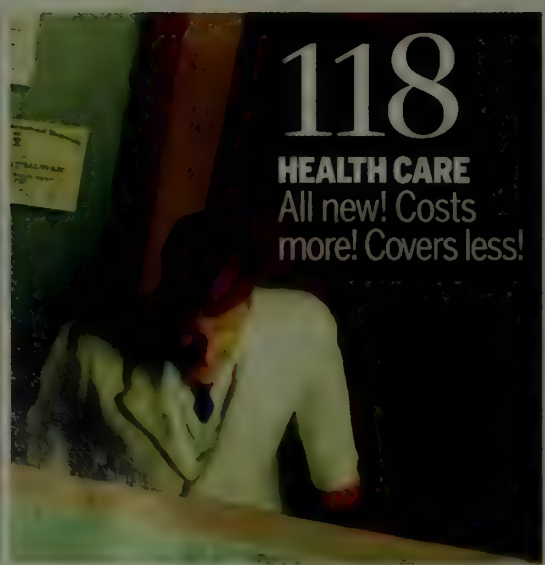

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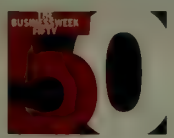

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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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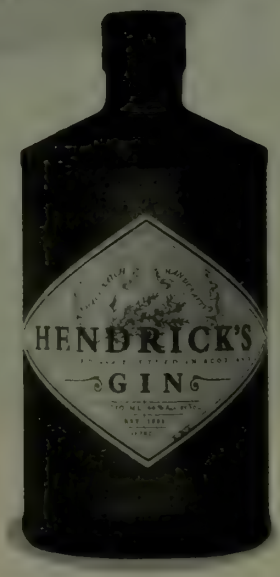

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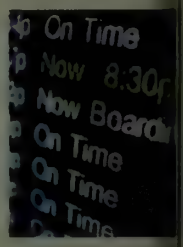
Putting Avian Flu Under the Microscope

This potentially deadly disease has governments and scientists on high alert because it could kill an estimated 150 million people. Just what is avian flu, why is it such a threat, and what can be done about it? You can find **the answers** to these and other pressing questions about the science, medicine, and emergency planning surrounding the strain known as H5N1. Plus: **Analysts from Standard & Poor's** plumb avian flu's economic impact and how investors can inoculate their portfolios

Google Goes Inside the Beltway

With major Internet and privacy issues looming, the search giant has hired its first full-time Washington lobbyist—and a bigger staff will follow soon. Some say it's about time

Airfares: Avoiding The Takeoff



Fuel prices and airline woes are sending ticket prices higher. But here are a few smart options that will save travelers plenty of bucks, though it'll take some work

Economists Try To Size Up the Storms

Standard & Poor's Chief Economist David Wyss says it's hard to determine how badly Hurricanes Katrina and Rita damaged the U.S. economy, but data show Americans reacted as usual—by going shopping

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UP Front

"We each have nuclear weapons."

–Robert S. "Steve" Miller, Delphi's CEO, on leverage that he, General Motors, and the UAW can exercise in Delphi's reorganization

TED BY DAN BEUCKE

COND ACTS

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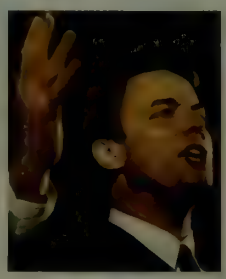


dwards has signed up to k for the New York ate investment outfit **ress Investment Group** as a -time senior adviser. He'll vide "support in eloping investment ortunities worldwide and tegic advice on global nomic issues," says Edwards keswoman Kim Rubey.

Edwards joins a growing line of relocated policymakers. Former Vice-President Dan Quayle has been sealing deals for hedge fund group **Cerberus Capital Management** since he dropped out of the 2000 Presidential race. Former Massachusetts Governor William Weld became a principal at **Leeds Weld** in 2000, although he is now a senior adviser while considering a run for New York governor.

Fortress has about $15 billion in equity under management, nearly half tied up in hedge funds. It has snapped up companies such as assisted-living provider **Alterra Healthcare**. Edwards should feel at home: In the 2003-04 election cycle, Fortress employees gave $143,650 to Democratic candidates, $4,000 of it to Edwards. They gave $10,500 to Republicans.

–Emily Thornton

WALLET WATCH

Goodbye to the Ace in Your Pocket

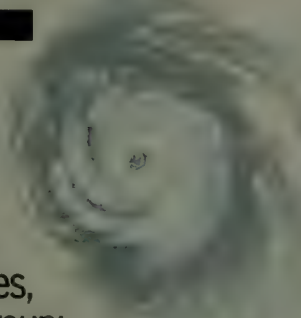
SOARING ENERGY PRICES are already stinging consumers. How much? Enough to wipe out any benefits they will get this year from tapping into home equity, according to one investment research outfit. **BCA Research** estimates that increased consumer spending on energy will burn up an additional 1.2% of aftertax income in 2005. That could add more than $100 billion to total nationwide consumer expenses, according to *BusinessWeek* estimates.

At the same time, after four years of homeowners pulling ever more cash from the rising value of their homes, the equity gusher is being capped by gradually rising interest rates. The net effect of these two forces will create a drag on aftertax income for the first time since 2000. That shift could be huge. Conversion of home equity into cash has been one of several powerful stimulants—including low borrowing costs and tax breaks—driving strong consumer spending in recent years, says Martin Barnes, managing editor of BCA Research's *Bank Credit Analyst*. Given signs that the housing market has peaked, Barnes believes "a moderation in the pace of consumer spending growth is overdue."

–James Mehring

E BIG PICTURE

INING MONEY The top 10 porate winners of post- rina federal contracts for bris removal, travel trailers, ise ships, and other services, cording to one watchdog group:



	IN MILLIONS		IN MILLIONS
RITT	$556.7	LANDSTAR EXPRESS AMERICA	400.0
LIPS AND JORDAN	544.2	CIRCLE B ENTERPRISES	287.5
STREAM COACH	521.4	MORGAN BUILDING & SPAS	257.8
S ENVIRONMENTAL	520.0	CARNIVAL CRUISES	192.0
RONMENTAL CHEMICAL	500.0	FLEETWOOD ENTERPRISES	170.0

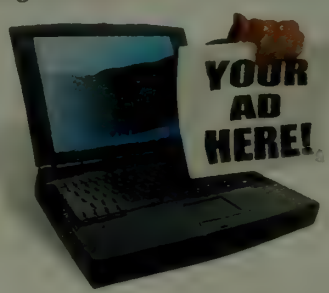
Oct. 11 **Data:** Taxpayers for Common Sense

UPFront

NET EFFECTS

SPAM ON MY BLOG? HORRORS!

INSPIRED BY THE success of viral ad campaigns, which try to promote products via word of mouth, some marketers are trying to build their brands by planting "comment spam" onto unsuspecting blogs. These sneaky ads appear more sincere than the typical "Check out my site!" spam. But they're popping up in unlikely places, often using made-up names—and sometimes they can backfire.



Tom, a London-based blogger who asked that his full name not be used, was hit by one such scheme after writing about renewing contact with his estranged biological father on his popular blog, plasticbag.org. A "Barry Scott" left an empathetic comment that ended: "Drop me a line if I can be of any more help." Tom recognized the name as that of the smarmy, fictional spokesman for **Cillit Bang,** a European household cleaner with the tagline, "Bang and the dirt is gone!" (The comment also hyperlinked to "Barry's blog," with a photo of the grinning salesman.)

Incredulous that anyone would use his heartfelt post to market a product ("a grotesque act"), Tom tried tracking the commenter's Internet address and calling ad agencies. Soon after, he received a letter from **Cohn & Wolfe,** part of **Young & Rubicam,** which called the comment "an error of judgement." Tom says he accepts the apology. He doesn't plan on buying any Cillit Bang, though.

–Elizabeth Woyke

A GAS GUZZLER'S BETE NOIR

Despite rising fuel prices, French drivers are in love with SUVs: Sales rose 17% through September and now account for 6% of auto purchases, up from 2% in 1998. But not everyone is so smitten. For the past month a protest group has waged a campaign against SUV owners in Paris and other cities. Calling themselves Les Dégonflés (The Deflated), the activists target the environmental impact of ga guzzlers via nonviolent tactics, such as letting air out of tires, smearing mud on windows, and leaving leaflets. "SUVs have become a status symbol in France, so we're showing owners tha not everyone thinks they're hot," says the 28-year-old group founder, who goes by the alias Sub-Sergeant Major Madcap. He hopes to expand by working with like-minded groups in Australia and California. *–Rachel Tiplad*

REWIND

WHO LEADS IN LEADERSHIP?

How do you find great board members? It has never been easy, but the quest took on more urgency in the search for good governance following the Enron, Tyco, and WorldCom scandals ("The Best and Worst Boards," Oct. 7, 2002, Cover Story). One way is to ask board members for the names of colleagues they admire.

That's how the Outstanding Directors Institute, which aims to lift the quality of boards nationwide, compiles its annual list of top directors. Just released, the 2005 ranking includes one surprising name—former Senator **Bill Bradley** (D-N.J.), who sits on the boards of Starbucks, Seagate Technology, and Willis Group. Starbucks Chairman Howard Schultz credits Bradley with helping his company to expand globally and design a health-care plan for employees.

Others who made the cut have a knack for supplyin leadership without knuckling under to the CEO: **John Phelan Jr.,** who pushed for more disclosure when he chaired the audit committee at Merrill Lynch; former Smith College head **Jill Conway,** who pioneered a plan to tie stock option prices to executive performance at Colgate-Palmolive; **Norman Matthews,** who helped keep execs from bolting during the Toys 'R' Us sale; and **A. Thomas Young,** who helped ease the way for new leadership at Science Applications International.

Rounding out the list are Nordstrom director **Rick Hernandez Jr.; Joseph Neubauer,** a director at Federated Department Stores and Verizon Communications, among others; Yum! Brands director **Andrall Pearson;** and Berkshire Hathaway's **Walter Scott Jr.** "These are not applauders," says institute Chairman Michael Griffin. "These are the people who go into the boardroom and challenge management." *–Diane Brad*

imageRUNNER 5570

The entire department heard Bob exclaim, "Cool!" as he used the Web browser on the new imageRUNNER 6570 to access and print his company's 4th quarter sales results.

ob's company isn't doing business as usual. What about your company? While "cool" definitely applies to the new nnon imageRUNNER® 70 Series, "groundbreaking" is more apt. Both the imageRUNNER 6570 and imageRUNNER 5570 ve the industry's first embedded Web access function – in other words, a full-size user interface panel that actually s you call up Internet or intranet data without the use of a PC, right from the device. Once you've done that, you can print e forms and documents you need to work more efficiently and productively. Of course, there are a host of other great features at help expand the potential of your workday. And that's definitely not business as usual.

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FACE TIME

JACK RUTHER

THE NAME BEHIND THOSE FACES

Jack Ruther's artwork might have the widest circulation of any living American artist. The lead bank-note designer at the Bureau of Engraving & Printing in Washington, he plays a key role in staying ahead of counterfeiters by updating the look of bills every 7 to 10 years. His new $10 bill, unveiled on Sept. 28 and hitting the street in early 2006, still features Alexander Hamilton (above; for security reasons the feds won't let us print Ruther's photo). But the design includes new security measures, such as an orange "security thread" in the paper that says "USA TEN" and is visible when held to a light.

His biggest challenge is "to change a currency and still make it look American," says Ruther, 61, who joined the bureau as an apprentice in 1968 and plans to retire soon. Size matters, too. There isn't enough room on a $10 note to display the Statue of Liberty, so her torch is highlighted. As for the $20 bill, redesigned in 2004, Ruther says: "We found if the eagle was too small, it started looking like a seagull or a chicken." *–Lauren Young*

THE DEAL MILL

A $445 MILLION MASSAGE FOR BROOKSTONE

THE iSYMPHONIC musical massage chair has proved quite a hit with overstressed Americans since it started showing up in **Brookstone** stores in July. The $3,995 leather throne comes with a built-in CD player, surround-sound synchronized music, and rollers that knead back and leg muscles. But the easy chairs are just a start for their supplier, **OSIM**, a Singapore company that is Asia's largest specialty retailer. On Oct. 7, OSIM completed a deal to buy a 55% stake in Brookstone, based in Merrimack, N.H., and its 292 stores for $445 million. That gives OSIM and CEO/founder Ron Sim a foothold in the U.S. and a chance to augment the company's network of 540 stores in 26 countries from South Africa to Ukraine.

Sim, 46, thinks the market for "lifestyle products," such as exercise bicycles, heart monitors, and water purifiers, has room to grow. Factories that make the iSymphonic in Japan already are working overtime to meet demand.

Today, Brookstone outlets in upscale malls bring in 90% of the company's annual revenues of $500 million. B Sim, who launched OSIM in 1979 as a 20-year-old with only a high school educatio aims to expand Brookstone' catalog and online operations. And he hopes t boost margins with even pricier items, such as OSIM new $5,000 iDesire full-bod massage chairs. *–Assif Shame*

AT YOUR SERVICE

THERAPY WITH YOUR LATTE? IT'S MY JOB

YOU'RE A STARBUCKS barista facing a line of 10 customers. One orders an eggnog latte and sighs in exhaustion. It's up to you to guess why.

Those are the rules of *Inside Out*, a board game Starbucks is sending to 8,000 managers in the U.S. and Canada on Oct. 28. The goal, to be hammered home during training sessions, is to challenge baristas to connect with customers. Roll the dice for the size of the line and time of day. Then pick a card: The front describes a customer, the inside, how the customer feels and why. In this case the sighing customer is doing last-minute Christmas shopping; the eggnog is a pick-me-up.

Spokesperson Sanja Gould calls the game "a tool that can help everyone understand...the connections they make every day." Figure out how to cheer up the customer (you might ask about the bags of presents—gift cards make nice stocking stuffers!), and everyone's a winner. *–Jessi Hempel*

THE STAT

48

The average number of days that it took for an American company to fill a job vacancy in 2004. The average cost per hire was $3,270.

Data: PricewaterhouseCoopers Saratoga 2005/2006 Human Capital Index Report

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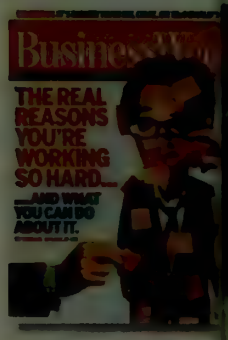
"Life is more than work, and...finishing early can be rewarded just as well as working late."

–Stanley Ngan
Hong Kong



WHY DO AMERICANS WORK SO HARD? LET US COUNT THE WAYS...

I AGREE THAT LEADERS making too many decisions is a huge problem contributing to "The real reasons you're working so hard..." (Cover Story, Oct. 3). However, meetings and e-mails get a bad rap. Connecting an organization and sharing knowledge are key needs in a modern global organization, and face-to-face meetings are a necessary component.

As for e-mails, executives who pride themselves on not reading them and have their assistants manage e-mails for them are not connected to the modern organization, and they may be slowing down the process and missing opportunities. If they would just let go and empower their organizations, we would all have better working lives.

–Ken Goldstein
Manhattan Beach, Calif.

MODERN ACCOUNTING has failed to persuade companies of the value of managerial time. The time of salaried workers appears to be free (barring termination), so this resource can be frittered away in low-value tasks. Activity-based costing might reveal just how much in corporate resources are wasted in the endless meetin and administrative tasks that fill the c porate day (and night). Instead of perce ing the salaries of managers and prof sionals as sunk costs, companies sho think in terms of opportunity costs. Th points to a second failure: a failure imagination that makes it so hard companies to conceive of the contrib tions their managers and skilled prof sionals might be making if they were always racing from one meaningl deadline to the next.

–Edward E. Rig
Georgia State Univers
Atla

THE REAL REASON why America over-work has nothing to do with co munication or collaboration. It is corporate culture in which only hardest-working few can survive an belief that work is the most importa aspect of life. The "Five ways to w smarter" totally missed the point, as t essentially only help workers save ti But if this work-is-everything mental does not change, I guarantee you a time saved will not be spent on family leisure (which should, in the long te

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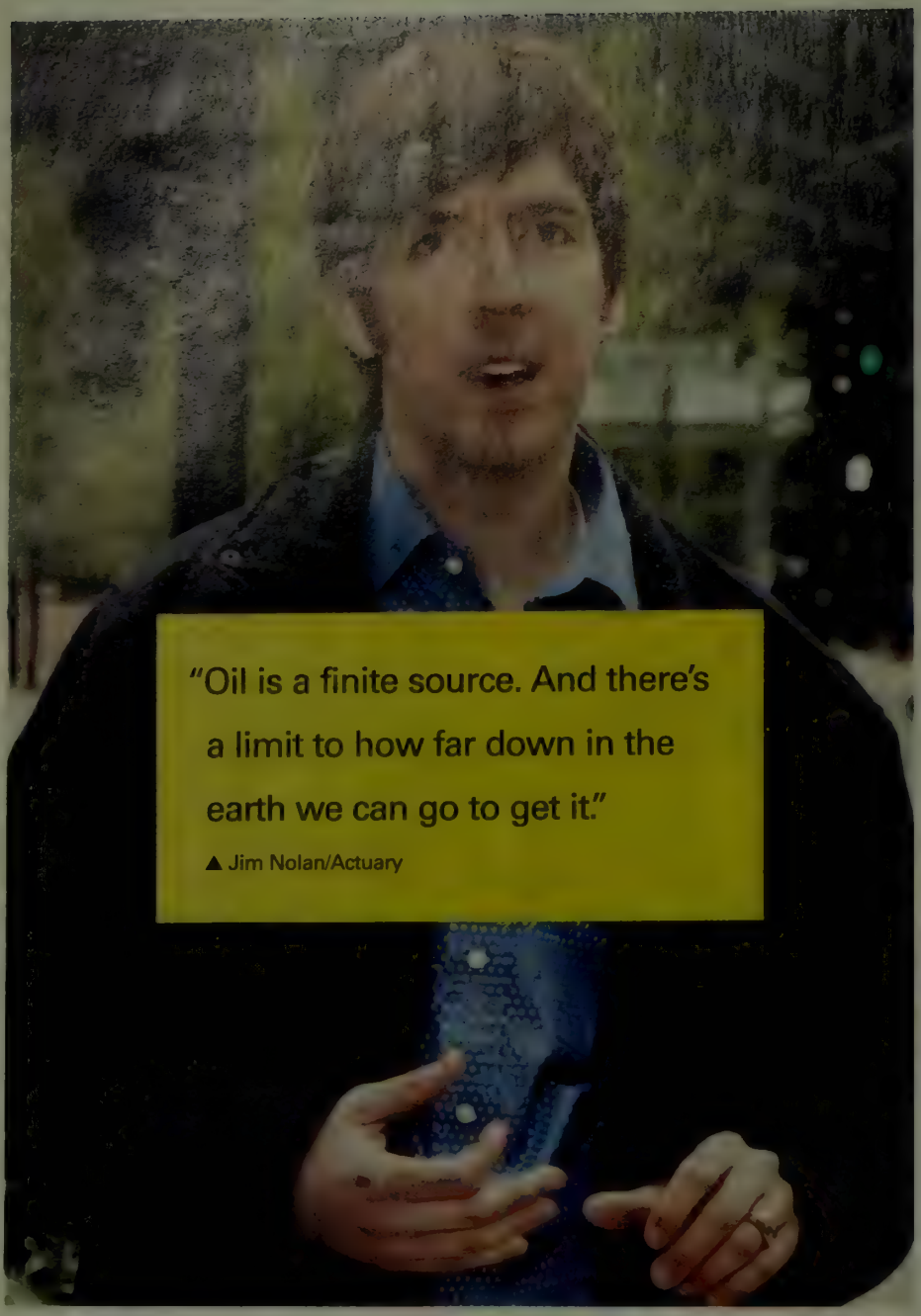

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Readers

CORRECTIONS & CLARIFICATIONS

BusinessWeek incorrectly reported in its Oct. 17 Capital Wrapup that the Senate Appropriations Committee exceeded its budget ceiling for defense spending. In fact, adjustments to that ceiling by the Congressional Budget Office meant there was no violation of the spending cap. The ceiling was $439 billion rather than the reported $410 billion.

In "A Tense Kodak Moment" (Finance, Oct. 17), *BusinessWeek* reported that the company expects to realize a total of $60 million in asset sales for the rest of this year and all of next year. Publicly, the company has forecast sales for this year of $250 million to $350 million. It has not provided a forecast for 2006.

In "The call of the Queen Mary" (Personal Business, Oct. 3) the extent of the writer's childhood ventures should have been a "two-mile radius" from home.

The subheadline for "Living too large in exurbia" (News: Analysis & Commentary, Oct. 17) should have read: "...A lifestyle built on cheap energy is in jeopardy."

lead to higher efficiency at work an better society at large) but on produci more of something else!

If there were a solution to this pr lem, it would be a complete change in titude that life is more than work a that finishing early can be rewarded j as well as working late.

–Stanley N Hong K

THE 1990S RUSH to replace U.S.-view corporate liabilities (secretarial and cl ical positions) with corporate ass (computers) so that one does his/ own file preparation, filing, addre keeping, letter-writing, voice-mail liste ing, etc., insidiously adds many hours routine clerical tasks to almost everyon weekly routine. The workforce tod does in fact work harder and longer, not better, as a result. Nor is it, traditi ally speaking, more productive.

–Paul Cr San Di

"THE OVERWORKED, networked far ly" is a sad commentary on family life America (Cover Story, Oct. 3). Ignori your kids at home while you work on weekend is excused as "multitaskin Whatever happened to a family spe

time together? Recent studies show children are less likely to get into ıble if they have regular meals with r families. Turn off the computer and TV and the cell phone, and ask your d how his or her day was.

–Ken Jacobs
Christiansburg, Va.

NEY'S NEW CHIEF APPRENTICED DER THE BEST

"CALMING THE CROWD after Eis- s thrill ride" (News Analysis & Com- ıtary, Oct. 3): With regard to the nges in Walt Disney Co.'s stock price r the announcement of the appoint- ıt of Robert Iger as chief executive, stors and others might consider at ABC, Bob studied under three of greatest masters of shareholder value American history: Warren Buffett, ital Cities/ABC Inc. CEO Tom Mur- and Chief Operating Officer Dan ke. These three gentlemen, with the of Capital Cities Chief Financial Of- Ron Doerfler, engineered the 1986 ıisition of ABC by Capital Cities ımunications at a price of $6 billion the subsequent sale of ABC to Dis- in 1996 at a price of about $19 bil- During those years, stock appreciа- was so great that the decision of ther to participate in the ABC em- ee stock-purchase plan was jokingly rred to as an IQ test.

Murphy and Burke also had the fore- t and good judgment to recognize the ership potential of Iger, elevating him ositions of increasing responsibilities.

–Ted Van Weeren
Longs, S.C.

or's note: The writer is a former ABC vision Network finance executive who ked at ABC for 28 years.

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Technology&You

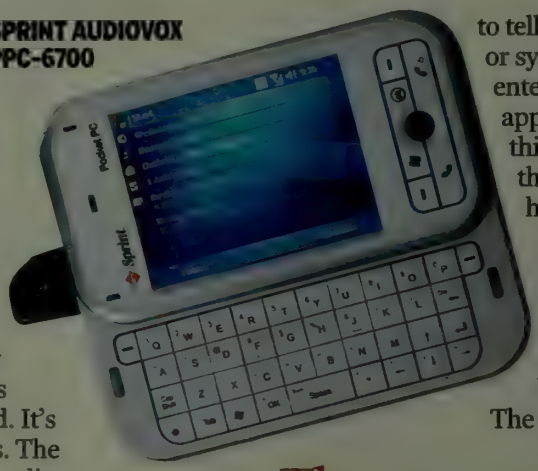
BY STEPHEN H. WILDSTROM

A Big Leap for Small Window

The conventional wisdom says it takes Microsoft three tries to get something right. Hitting the target with phones and wireless PDAs took longer, but Windows Mobile 5 does it. And with a variety of devices due c in coming months, Microsoft is becoming a huge player in a market that had been dominated by Palm and Research In Motion's BlackBerry.

A key to the recent success was Microsoft's realization a couple of years ago that hardware companies knew more about device design than software engineers. So Microsoft stopped trying to dictate the design of Pocket PCs and Smartphones and freed hardware makers to innovate. The Audiovox PPC-6700, $480 with a two-year service contract from Sprint, shows that Microsoft made a wise choice.

SPRINT AUDIOVOX PPC-6700



The PPC-6700 is designed and made by Taiwan's HTC, which offers similar devices through wireless carriers around the world. It's about the size and shape of a pack of cards. The 1¾-in.-by-2¼-in. display works like many earlier Pocket PC Phone Edition products: You dial by using the keypad on the touch-sensitive screen. It gets more interesting when you slide the top of the PPC-6700 to the right to reveal a keyboard. Rotate the device to orient it horizontally, and you have a nice e-mail device with a keyboard bigger than those of a Palm Treo or a BlackBerry.

THE BIG SOFTWARE IMPROVEMENTS are in the integration of the keyboard, which was treated as an afterthought in earlier Windows Mobile versions. Even when a hardware keyboard was available on these older models, the software would occasionally determine that you needed to enter text and then cover half the screen with a virtual keyboard you were supposed to tap with a stylus. That annoying feature is gone. The new Windows Mobile lets you do just about everything from the keyboard, which makes the stylus all but obsolete—and it eliminates the feeling that you need three hands to use the software. The PPC-6700 takes advantage of its extra keyboard space to add the familiar up, down, left, and right keys from a PC keyboard, a major convenience.

Still, Windows Mobile developers should study products from Palm and RIM if they want to make keyboard use natural. For example, both the Treo and BlackBerry have software that is smart enough to shift automatically to number mode when you type in a contact's phone number; the PPC-6700 makes you press the "symbols" shift key. The Treo also displays icons to tell you whether you have pressed the c or symbols shift, which is nearly essentia entering complex passwords that don't appear on the screen. These are little things—but small touches loom large i the area of usability, and their absence hurts the PPC-6700.

The device offers three forms of wireless: short-range Bluetooth, useful mainly with headsets; Wi-F and Sprint's two data services ($1 month for unlimited e-mail and W browsing).

The standard data network, available everywhere, is adequate handhelds, which typic don't require huge gulp data. Sprint's high-spee EV-DO network is even better—especially for W browsing—but it's avail only in major cities, and inconsistently at that. A for Wi-Fi, mostly I foun a nuisance and turned t radio off. When left on, not only sucks battery power but also annoyingly lets you ku every time it senses a new network, whether you are looking one or not. Switching between the different wireless service also a clumsy business. In the end Wi-Fi seemed useful mai in offices, homes, or hotspots where Sprint reception is poor

The newest Windows Mobile software makes keyboard use easy

Windows Mobile 5 is a big leap forward, and the PPC-670 a good product. But I'm holding out for the Windows Mo Treo, due early next year from Palm and Verizon Wireless. P is the first Microsoft licensee that is permitted to modify the sic software. That, combined with Palm's Treo expertise, co give us the ultimate Windows Mobile product. ■

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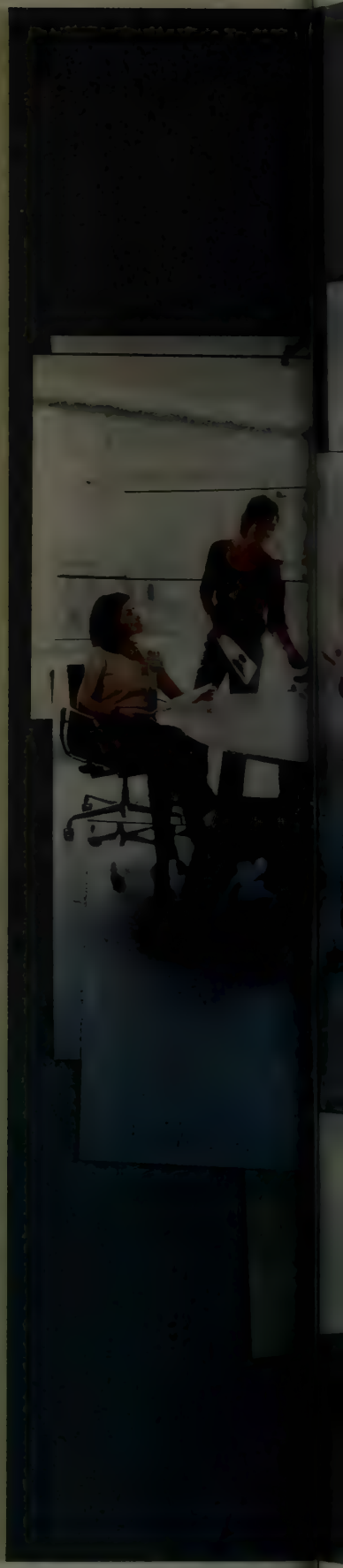

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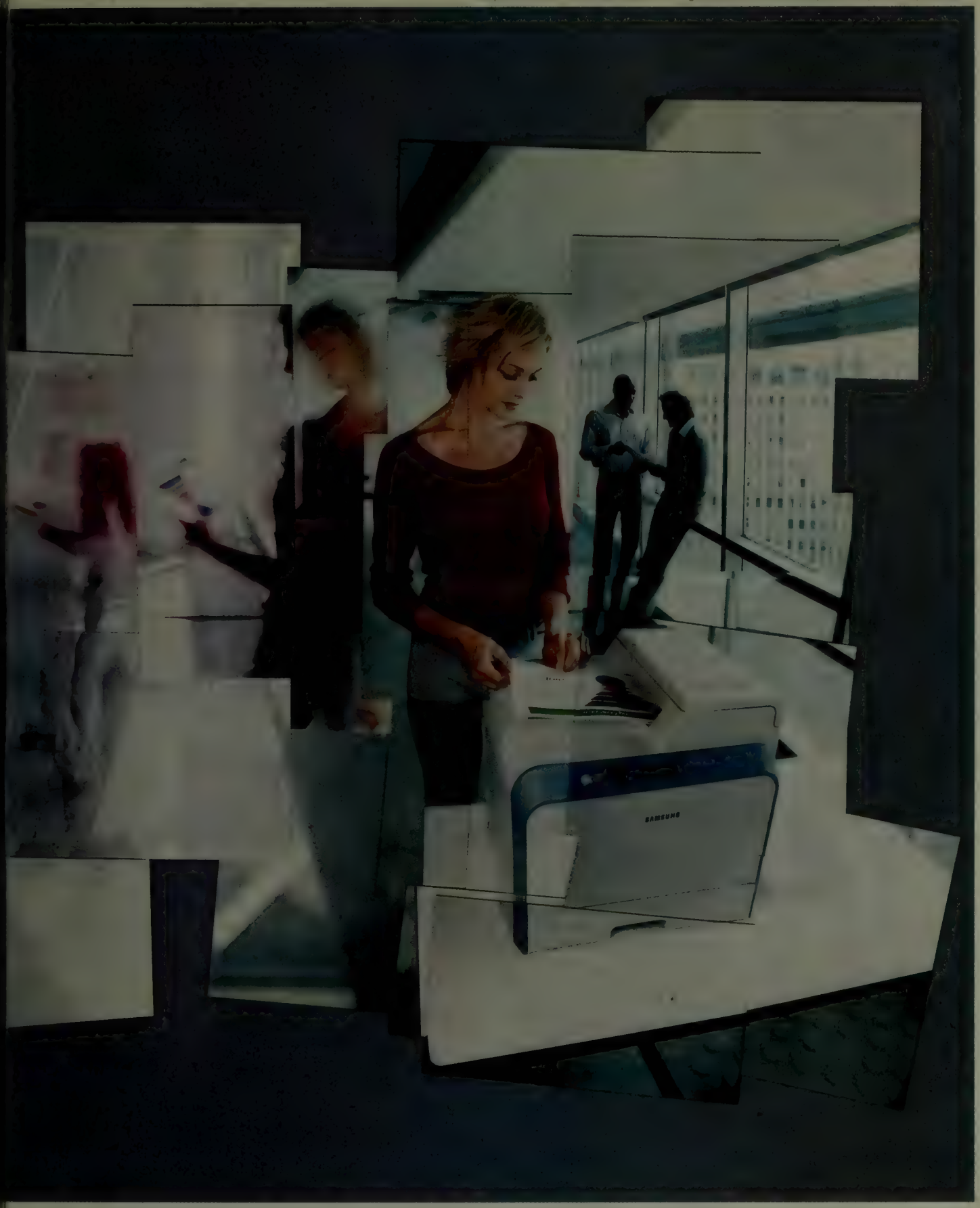

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Hard Questions from Google

If there's one image to remember from early October's Association of National Advertisers conference, it features the bespectacled gentleman with an accountant's charisma who quietly posed simple queries. Thing is, the questions held enough tonnage to crush virtually all assumptions underpinning advertising and media. He might have been dismissible, were he not the chief executive of Google Inc.

"How do we get the numbers right?" wondered Eric E. Schmidt during his presentation to a room of top marketing executives. If broadcast TV takes in around $46 billion in yearly ad revenue, he posited, "how do we prove" that's the right amount to spend? And, asked Schmidt, "given [that] advertising is a fundamental aspect of commerce, why not do it right? Why not target it?"

SCHMIDT The CEO's talk terrified Old Media types

Coincidentally, Google is a $3 billion player in hyper-targeted ads via its business selling AdWords and AdSense. Also coincidentally, Schmidt's stirring vision of the future in which technology drives economic liberation places Google more or less at the center of everything.

It's tempting to overstate the significance of all things Google, and it has been overstated, many times. We have seen much of this movie before—the nearsighted geek outlining the technology-enabled, blue-skied future that's ineradicably linked with that geek's business. (Although it most plausibly starred Bill Gates, many other actors auditioned during the dot-com boom.) The thing about Schmidt and Google, though, is that Google's offerings actually—how do you say this?—work well. Old Media executives who didn't profess boredom at Schmidt's speech—he's not the most dynamic performer, but this is a crucial part of the act—expressed something like quiet terror.

Of course, entire established media and marketing forms don't disappear overnight. And there is a pretty big boneyard of once-dominant tech names ranging from Atari to Wang Laboratories. Google is a product with zero switching costs; if a different and better search site comes up tomorrow, there's nothing stopping a mass consumer migration.

So Google isn't invincible, and the realistic fear isn't that TV and newspapers will vanish. The realistic fear is that ad dollars will shrink an additional 10% or 20% as their long-held value is assaulted by a worthy adversary. Google provides an automatic return-on-investment measure for a marketing world increasingly obsessed with ROI. If someone clicks on a company's link, it pays; if someone doesn't, the company doesn't. This comes as corporations are demanding better accountability for their massive ad spending.

At the conference, execs from some of the most traditional companies (who control some of the biggest marketing budgets) described big shifts away from traditional media. Wachovia Chief Marketing Officer Jim Garrity said his research on ad effectiveness would sadden broadcast TV execs but gladden employees of Yahoo! and—yup—Google. Joseph V. Tripodi, a good-humored old-school salesman, is Allstate's chief marketing officer. He told me Allstate's spending on "nontraditional media"—from the Internet to sponsorships—increased from 5% to 25% of its marketing budget in recent years.

Asking advertisers: What's the right amount to spend?

Titans of traditional media are all too aware of this shift. Vanity Fair Editor-in-Chief Graydon Carter last month told an audience of advertisers that while he often uses Google, he never remembered the ads. Schmidt countered by using Vanity Fair as Exhibit A: Its circulation is around 1 million, he said, and a full-page ad for a Prada bag costs around $100,000. So that ad in Vanity Fair costs 10¢ per impression. How about paying about 20¢ per impression, he offered, for a link to a Web site where you can buy the bag?

In truth, *Vanity Fair*'s ad is cheaper per impression if you measure by the magazine's total audience, but Schmidt's point is nonetheless clear: Which gets you closer to commerce, and how much do you pay for that? So goes this tech-driven narrative of the future. We have seen much of this movie before. But suddenly I'm not sure how this one ends. ■

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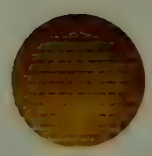

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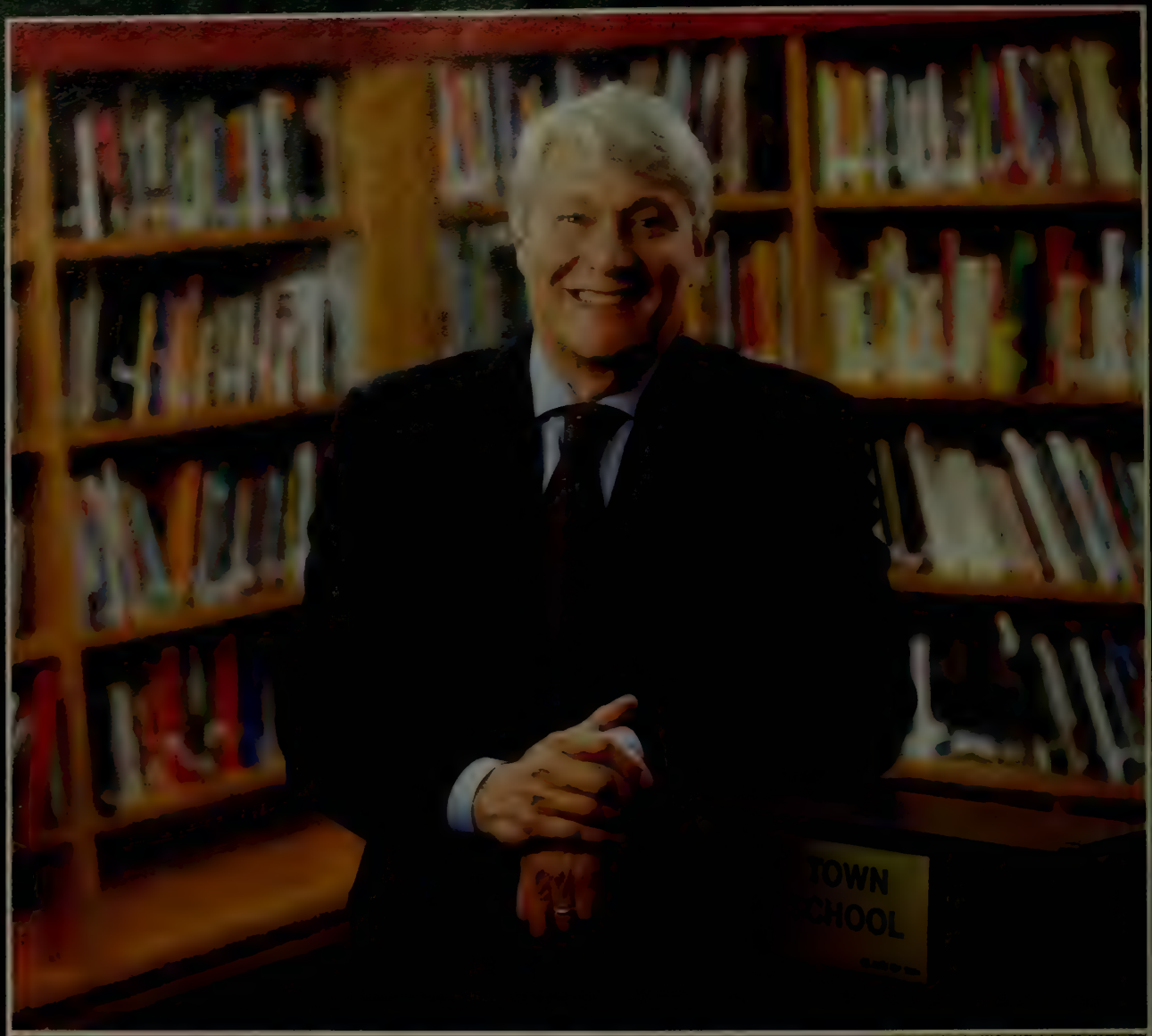

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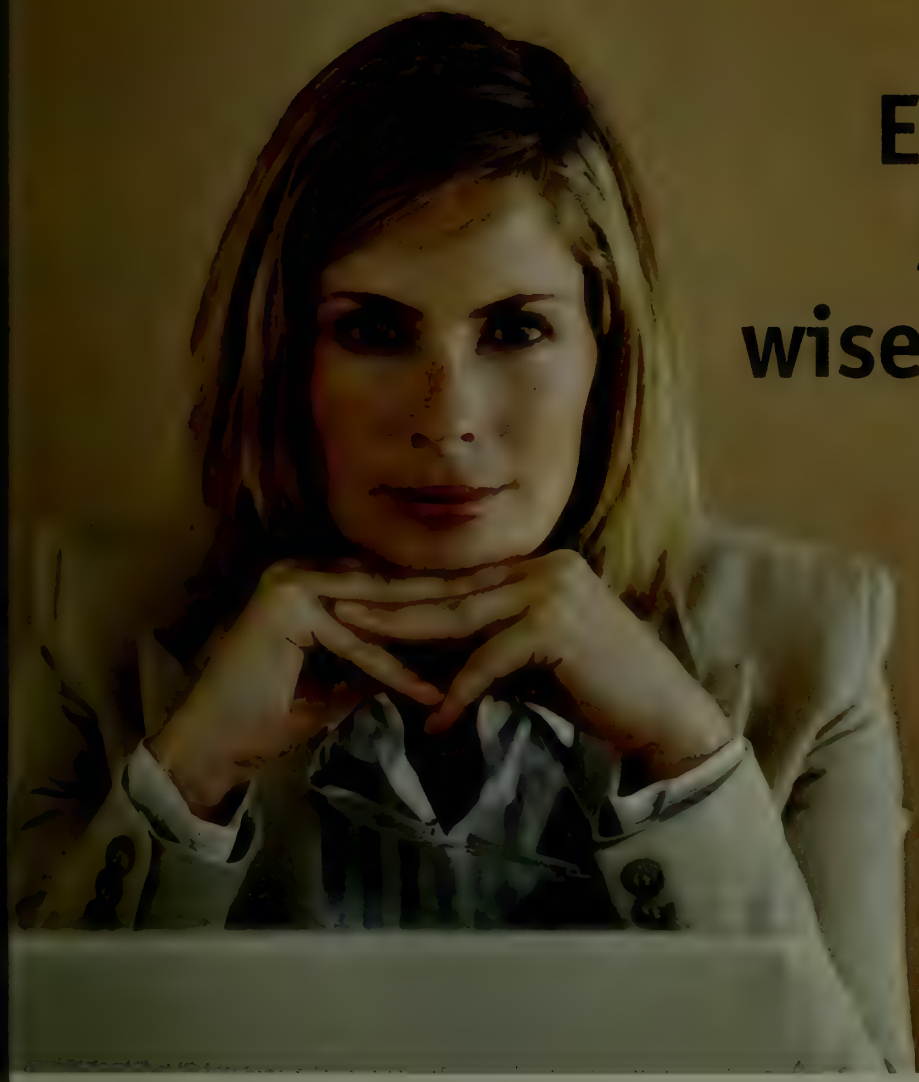

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The Barker Portfolio

BY ROBERT BARKER

Valero's Sweet Spot

Seen as evil polluters by some not so long ago, oil refiners may now be viewed as necessary evils. So when William E. Greehey, CEO of the top independent refiner, Valero Energy, hit Washington on Oct. 3 to lobby the Energy Secretary, suddenly he was also invited to meet with Vice-President Dick Cheney at his home.

Greehey's message, which he delivered separately to both the Vice-President and Energy Secretary Samuel Bodman, was twofold. First, Uncle Sam should extend tax incentives not just for construction of new refineries but also to expansions of existing refineries. Second, the government should issue the necessary permits faster. Greehey told me he's confident he got his points across. Whether his views will—or should—prevail is debatable, yet for investors in refining stocks, the fact that Valero wants to expand seems necessarily bullish. I say this despite the mega-returns in refiners' shares, which in 2005 have averaged 116%.

PROFITS Sour crude is boosting margins

NO QUESTION, A ONCE-DEEP undervaluation of independent petroleum refiners—a group of six independent refiners that returned an average of 107% in 2003 and 94% in 2004—has been righted. Yet the stocks still trade at middling to low multiples (table), and there's reason to expect further, if more modest, gains. To see why, imagine you're a refiner. You've been in a boom, making more money than ever, quarter after quarter, because long ago you invested in a scarce resource, the ability to turn oil into gasoline. Suddenly, to quell public dismay at the high price of your products, the White House issues a call (as President George W. Bush did Sept. 26): "We need more refining capacity. And I look forward to working with Congress . . . to expedite the capacity of our refiners to expand and/or build new refineries." That might sound as if Washington wants to dull your gloriously profitable edge. To investors, it might ordinarily sound like a clanging sell signal.

Yet these are not ordinary times. Refiners remain eager to expand because the economics of oil refining—a yawning gap between domestic supply and demand—are so bullish that added capacity is unlikely to dent profit margins any time soon. It will take years for new or expanded refineries to boost supplies. Meantime, America keeps sucking in imports. At last report, the U.S. was importing record levels of gasoline—1.4 million barrels per day, or 56% more than a year ago. Yet demand is running so high that inventories kept falling.

Eventually, more supplies of crude oil interrupted by the hurricanes will reach refineries, refineries that were shut down by the hurricanes will start producing again, domestic supplies will rise, imports will fall and prices will adjust. Valero's Greehey, however, sees his company's profit margins staying at least as wide as they are, if not getting wider. With a focus on the harder-to-refine sour types of crude oil, Valero's profits are being boosted by a glut in supplies of sour crude, which means its feedstock is relatively cheap. "We're going to have a great year this year," Greehey told me. "And next year is going to be even better...even if the economy slows down."

Naturally, not all refiners are identical investments. Sunoco, for example, isn't benefiting from the current low price of sour crude as it refines mostly higher-grade oil. It's also more diversified than most (less than half of sales are from refining; most of the balance is from retail sales of fuel and convenience-store items at its gas stations) and it pays the highest dividend yield, 1.1%. Some smaller players, including Holly and Giant Industries, are trading at noticeably higher multiples. All in all, though, count on the whole group to linger in Fat City. If I had to pick only one, given its scale, ambition, and lower valuation, it would be Valero. ■

E-mail: rb@businessweek.com

Oil Refiners: Room to Grow?

COMPANY (SYMBOL)	PRICE MILLIONS	YIELD	EV*	EBIT**	EV/EBIT	2005 RETURN†	BARRELS/ DAY
Frontier Oil (FTO)	$38.78	0.4%	$2,244	$230	9.8	192%	162,000
Giant Industries (GI)	52.28	Nil	986	88	11.3	97	105,000
Holly (HOC)	56.26	0.7	1,965	151	13.0	103	109,000
Sunoco (SUN)	73.19	1.1	11,900	1,139	10.4	81	890,000
Tesoro Petroleum (TSO)	59.99	0.3	5,292	633	8.4	89	560,000
Valero Energy (VLO)	105.04	0.5	31,277	3,698	8.5	132	3,250,000

Income statement data are for the 12 months ended June 30 *Enterprise Value **Earnings before [illegible] and taxes †Through Oct. 10

Data: [illegible] company reports

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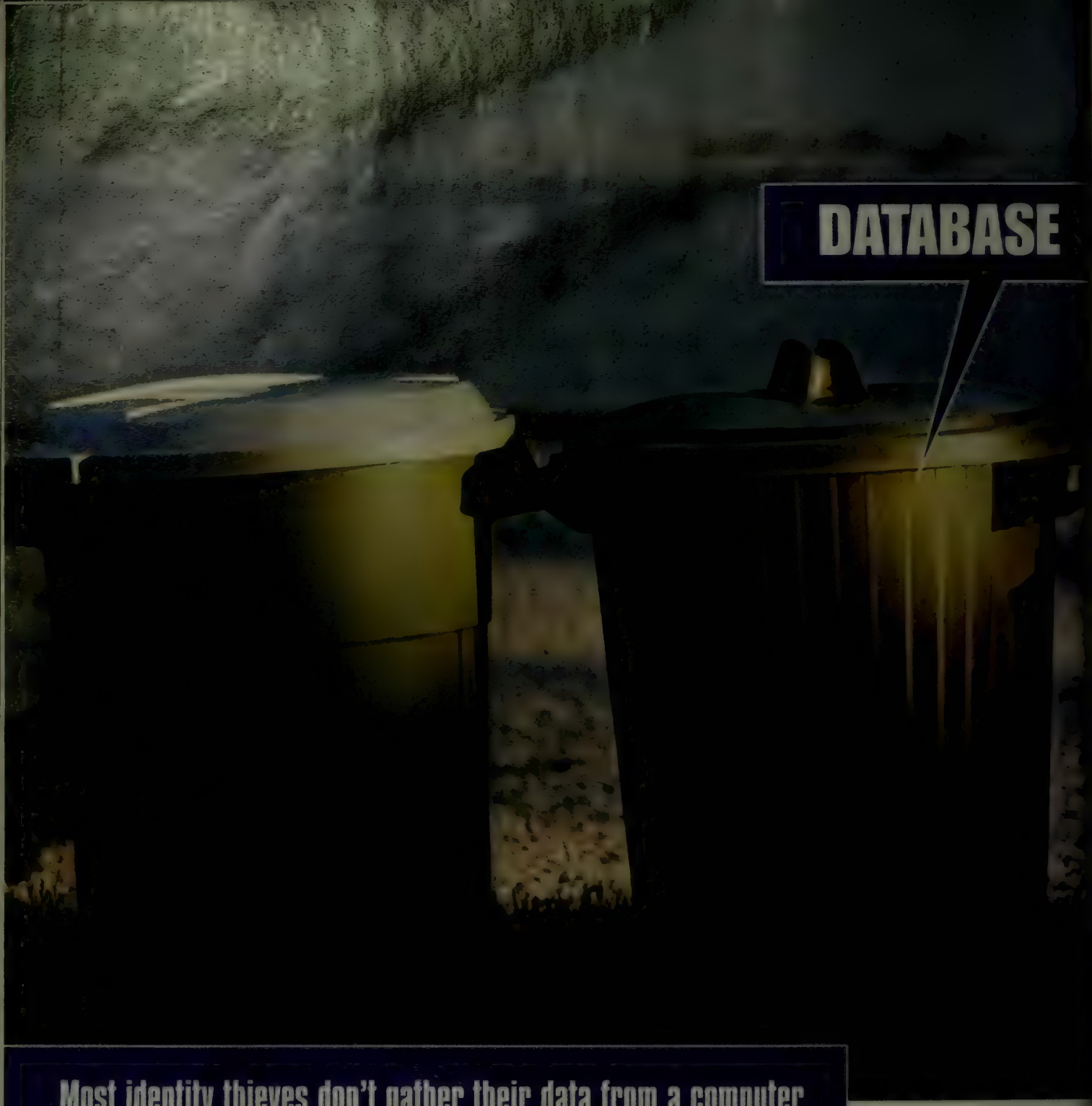

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AMES C. COOPER & KATHLEEN MADIGAN

Consumers Are Finally hifting Into Lower Gear

not just energy. As rates rise, homes will no longer be cash cows

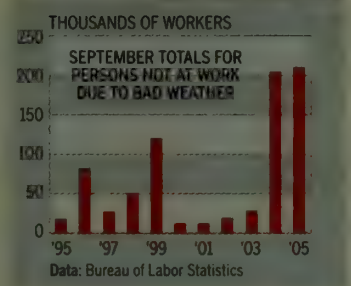
U.S. ECONOMY Since this economic upturn began almost four rs ago, the consumer has powered the gains in demand. But now s Energizer Bunny looks to be slowing down. That's not necessarily ad thing, since the business sector and the government's rricane-rebuilding effort will pick up much of the slack, and a

ding pause will give shoppers time to pare down loads and add to savings. But considering that ehold buying accounts for more than two-thirds of gross domestic product, any turn in this sector ges the direction of the overall economy as well. e latest spike in oil prices along with the Federal rve's resolve to hike interest rates have accelerated rosion in consumer fundamentals. Cheap loans are ming a thing of the past. Faster overall inflation is ezing purchasing power. And most important, a e can no longer be treated as a piggy bank, a reversal rtune that could cause a bigger drain on the economy the slowdown in home construction alone.

is is no temporary downshift. Higher fuel prices t going away, and the growing fear is that they are ing into the prices of other goods and services. The eems intent on raising short-term rates further, and ion worries in the bond market are pushing up long , too. All this will put a strain on households, cially low-income families, at the same time that heating bills hit monthly budgets this winter. nsumers will no longer be able to rely on the same orts that had propped up their spending through h of this expansion. Instead, gains in demand will nd even more crucially on the performance of the r markets and how workers perceive their own job rity. Real consumer spending has grown at nearly a nnual rate for the past two years. But for the end of 5 and into early 2006, the pace will probably ease to t 3%. A slowdown to that level is no disaster, but it ests that retailers could be disappointed during the lay shopping season and into the new year.

KEY WILL BE THE LABOR MARKETS. They still to be in good shape. Because of work disruptions Hurricanes Katrina and Rita, payrolls fell by 35,000 ptember. But that was far fewer than what omists had expected, perhaps because many large panies continued to pay their workers even if ities were closed. The Labor Dept. counts workers as loyed if they are receiving a paycheck. onetheless, the hurricanes skewed last month's ey. Labor reported a sharp drop in data-gathering interviews in Louisiana, Mississippi, and Texas. And 210,000 nonfarm workers could not get to their jobs because of bad weather. That compares with 205,000 in September, 2004, when four hurricanes hit (chart). This September's drop in work attendance, along with the strike at Boeing Co., suggests that measures of output may show a larger decline than what the small payroll drop implies.

ONE MEASURE OF KATRINA'S IMPACT



Data: Bureau of Labor Statistics

Other data, however, indicate that labor markets were healthy at the end of the third quarter. The average workweek was at 33.7 hours, the same length since May. Construction added 23,000 jobs, professional services hired 52,000, and education and health payrolls grew by 49,000.

Excluding the hurricanes' impact, Labor said payrolls in September would have increased in line with the 194,000 monthly pace averaged over the year ended in August. During that period, real wages and salaries grew 3.5%. With business surveys suggesting that post-Katrina hiring will bounce back, future pay gains should be strong enough to keep consumers spending, but other sources of cash will begin to dry up.

UNDOUBTEDLY, THE BIGGEST DROUGHT will come in home financing. A housing-sector slowdown will exert a direct drag on economic growth (page 40), but the secondary impact may be even greater, given how homeowners are using the capital gains from their houses to finance their spending.

A recent Fed study calculated that households extracted $600 billion in cash from their homes in 2004. The money came from homes being sold, cash taken out during refinancings, and home-equity loans. Previous studies have shown that one-quarter to one-third of that money is used for current consumption. So equity extraction financed 30% to 40% of the increase in

consumer spending last year, accounting for close to one percentage point or more of total real GDP growth of 4.2%. (For comparison, the residential-building sector of GDP kicked in just 0.6 of a point last year.)

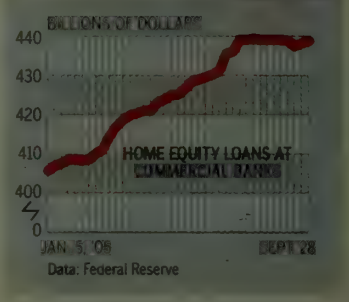
Now, however, higher interest rates and slower home price appreciation are cooling cash-outs. The level of home-equity loans at commercial banks has plateaued since July (chart). Mortgage broker Freddie Mac forecasts that cash-outs taken during refinancings will total $162 billion this year. While that's up from $140 billion in 2004, Freddie Mac reckons that $102 billion already has been cashed out in the first half. So it expects just $60 billion to be extracted in the second half. It forecasts that cash-outs will then slip to only $69 billion for all of 2006.

THE LOSS OF an easy source of cash could not come at a worse time for many consumers since high heating bills, rising borrowing costs, and potential price increases for other items will cut into family budgets. The Energy Information Administration presented its winter heating forecasts on Oct. 12 and projected that homes heating primarily with fuel oil will see a 32% jump in their heating bills this winter. Homes heating mainly with natural gas will suffer a 48% increase.

Hefty heating bills will take the biggest bite out of the finances of households that are already struggling. A survey of credit-card use by lower- and middle-income families done jointly by public policy groups Demos and the Center for Responsible Lending shows that, on average, one out of three households surveyed used their credit cards to cover living expenses in four of the past months. Unless job markets tighten enough to lift the wages of low-paying jobs, these consumers face the toughest going if fuel bills stay high.

That's on top of possible price hikes for other items. With the economy and job markets growing, there is a potential that businesses will try to mark up the prices of their products in coming months. Policymakers at the Fed are concerned about new price pressures, as seen in the minutes of their Sept. 20 policy meeting. The minutes show that the Fed has lifted its forecast for core inflation in 2006 and policymakers concluded that "further rate increases probably would be required."

HIGHER RATES START TO BITE



Worries about higher fuel costs pushing up other prices have caused long-term rates to increase as well. The twist for the outlook: Higher mortgage rates will only make it more difficult for consumers to take cash out of their homes, creating a bigger drag on spending.

For years, consumers have been a resilient lot. Terrorist attacks, corporate scandals, and Fed tightening have not swayed them. But the latest spike in energy prices may prove to be one blow too many. ■

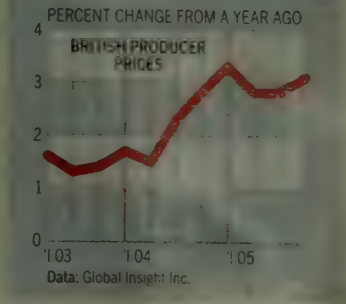
BRITAIN

Battling Both Inflation and a Slowdown

THE 50% SPIKE in oil prices this year is adding a twist to the Bank of England's policy decisions. Now the BOE must decide which is more urgent: propping up a weak economy or keeping inflation under control.

Costlier energy has already lifted annual consumer inflation to 2.4% in August, the highest in eight years and above the BOE's 2% target. Signs of increased pricing power even show up in the beleaguered factory sector. In September prices of goods leaving British factories increased 0.7%. Since June they have risen at a 7% annual rate, implying growing price pressures in the production pipeline.

ENERGY FUELS PRICES OF FACTORY OUTPUT



After a series of rate increases aimed at cooling a red-hot housing market and consumer spending, the BOE cut its target interest rate by a quarter-point on Aug. 4, to 4.5%, because of concern that the economy was slowing too rapidly. Revised data for gross domestic product show the economy grew 1.5% in the year ended in the second quarter, the slowest pace in 12 years. But the new inflation risks may limit further cuts and heighten tensions within the BOE's policy committee. Four of the nine policymakers opposed the Aug. 4 rate cut, including Governor Mervyn King.

Growth in the second half will show little improvement, say economists. Weak industrial output will be a drag in the third quarter. The labor markets softened further in September, and consumer spending continues to slacken more sharply than the BOE would like.

The Confederation of British Industry recently projected a tough holiday selling season for retailers. The trade group's latest survey shows that half of its retailers said sales were down from a year ago, with only a quarter reporting improvement. The net balance of −24% was the lowest in the survey's 22-year history.

Neither capital spending nor exports are taking up the slack. Exports to Europe, which account for half of Britain's trade, face a double whammy: a weak euro zone and new competition from Asia.

So, what will the BOE do? The key is consumers. If they continue to wilt, then inflation will be unlikely to take hold. If they prove resilient, then the BOE will be justified in keeping rates in a holding pattern. ■

Rich Draper
MLB Reporter

Regina Rafael
MLB Advanced Media

Darren Fieulleteau
Sun, System
Support Engineer

Frank Ciancaglini
Sun, Area System
Support Engineer

Bill Schlough
VP & CIO,
San Francisco Giants

Giants Fan
User Name: SFBatBoy

Share the game. Baseball fans have massive appetites for information. That's why MLB Advanced Media and Sun collaborated to create MLB.com. Enlisting Java™ and Solaris™ running on Sun Fire™ servers, fans can catch live game broadcasts, watch and listen to pre- and post-game shows, chat with players and coaches, play fantasy and arcade games, and visit their favorite team's virtual clubhouse, including SFGiants.com. In 2005, the world's largest Internet producer of live sporting events welcomed fans from around the world more than one billion times. The pastime is the passion. The network is the computer.™ Share.

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INVESTIGATIONS

ANOTHER FISHY HEDGE FUND

A mysterious money manager, nonstop hype, plunging returns, empty offices, and now an SEC probe—the intrigue at Wood River deepens

BY JUSTIN HIBBARD AND ADRIENNE CARTER

KETCHUM, IDAHO, IS THE kind of place where people tend to know each other. Close to the Sun Valley ski resort, the tony town of 3,873 boasts several Wall Street refugees who manage money for wealthy neighbors and clients elsewhere. Yet few residents say they know John H. Whittier, a 39-year-old money manager who moved to the area about five years ago and opened an office for his fledgling hedge-fund firm, Wood River Capital Management, named for the picturesque river that runs through Ketchum. Locals describe Whittier as an absent-minded-professor type who drives a Lincoln Navigator and sometimes fetches his morning coffee from a Tully's café in his pajamas. Beyond that he keeps to himself, they say.

Investors in Wood River's funds apparently didn't know much about Whittier, either. The ex-stock analyst at investment bank Donaldson, Lufkin & Jenrette presented himself as a savvy stock trader overseeing hundreds of millions of dollars for investors. Marketing materials for his flagship fund trumpet 25% returns in the first eight months of this year, a period when the stock market was basically flat. But some investors got nervous and tried—unsuccessfully—to get their money back late last month when Whittier's big bet on an obscure Silicon Valley stock slumped badly, say investors' lawyers. The firm stopped answering its phone. Last week, Wood River's offices in downtown Ketchum were locked and apparently unoccupied. FedEx packages piled up outside next to strollers and a red wagon left by Whittier's two young children.

Wood River is now the subject of a preliminary investigation by the Securities & Exchange Commission—the latest hedge-fund scandal that is sure to intensify calls for greater government oversight of these lightly regulated investment pools. Only two weeks ago the founders of collapsed Bayou Management, a hedge fund in Stamford, Conn., pled guilty to criminal fraud. As in the Bayou affair, Wood River presented red flags that careful investors should have noticed. The firms Wood River's promoters named as its outside auditor and bookkeeper, for example, say flatly that they didn't provide those services to the hedge fund. Morgan Stanley, listed in April as one of the hedge fund's two prime brokers, in fact was not, according to a person familiar with the matter.

The full picture of what unfolded at Wood River isn't yet in focus. Whittier and others at the firm remain incommunicado. An attorney for Wood River didn't return phone calls. But the case clearly illustrates the perils of a secretive sector of the investment industry flooded in recent years by institutions and wealthy individuals hungry for outsize returns. Other potential danger signs included Whittier's self-proclaimed transformation from low-profile analyst to would-be investment seer. His purported stock-picking skills were promoted by a half-

RAPIDS Wood River, like others before it, points up the laxity of hedge-fund regulation

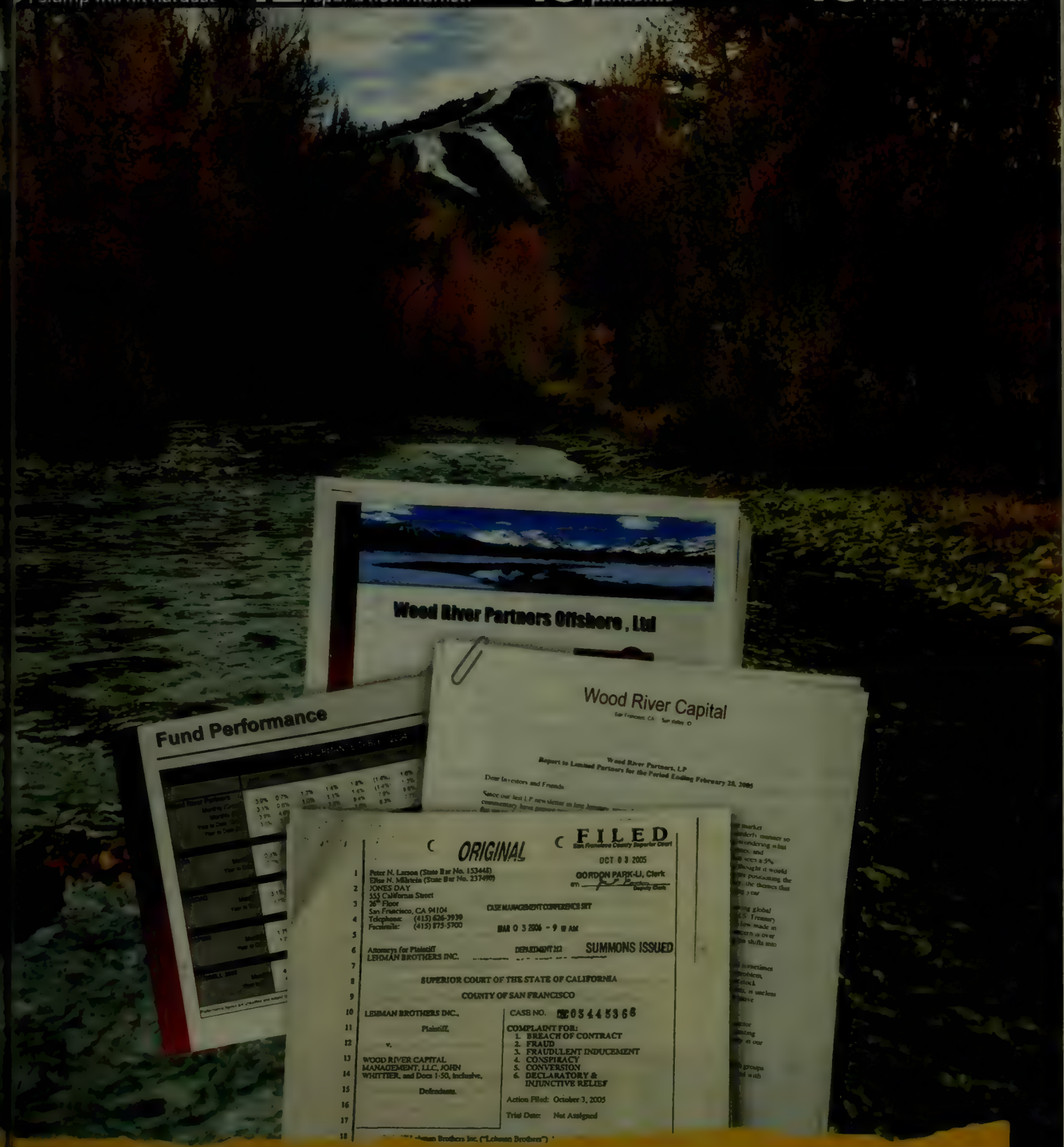
IN THIS SECTION:

Where a housing slump will hit hardest

42 Can Apple's video iPod spur a new market?

45 New vaccines for a pandemic

48 Neuroscience and love—a new match



"Wood River and Whittier received into their own accounts the approximately $20,888,000 that Lehman Brothers transferred to Merrill Lynch, thereby converting funds that are the rightful property of Lehman Brothers."

–Lehman Brothers Inc. v. Wood River Capital Management

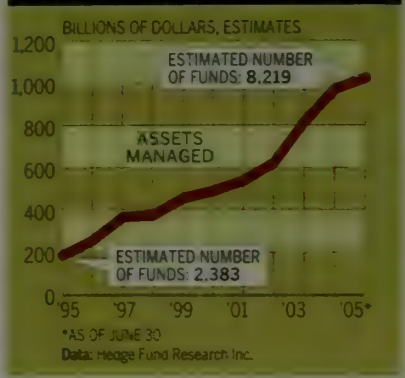
dozen other firms that specialize in luring investors to hedge funds.

A 69-year-old retired insurance executive in North Carolina says he invested $1 million with Wood River this year based on the recommendation of two friends who know Whittier. The investor, who asked not to be named, says everything he heard about the money manager made him sound "like the kind of guy you'd want for a brother or a son." Whittier graduated from the University of California at Berkeley in 1989 and has said that he worked for two years as a Republican political aide before moving to the financial world. The first warning the North Carolina investor got came last month from the SEC, which asked him for all communications he received from Wood River. Since then he has been phoning, faxing, and e-mailing the hedge fund—to no avail. Worried that he'll lose the entire $1 million, he says: "I'm pretty much finished with hedge funds."

Financial industry veterans fear Wood River won't be the last of its kind to fizzle. As hedge funds proliferate and competition increases, more are bound to fail, predicts Barry P. Barbash, a former director of the SEC's investment-management division. "They're going farther out on the risk curve," says Barbash, now a partner at law firm Shearman & Sterling.

Big Wall Street firms aren't immune to the allure of hedge funds. Lehman Brothers Inc., which, like its rivals, has scrambled to win trading business from hedge funds, alleges that Wood River drew it into a fraudulent stock transfer in September. In a lawsuit filed in California state court in San Francisco, where Wood River also has an office, Lehman claims the fund tricked it into wiring nearly $21 million to a Wood River account at Merrill Lynch & Co. Then, the suit says, Whittier and Wood River tried to grab the money. "Brokerage firms have become very dependent on hedge funds," says Barbash, the former SEC official. Without referring specifically to Lehman, he adds: "A lot of times what passes for due diligence is really unverified hearsay." Lehman declined to comment. In a statement, Merrill said it recently ended its relationship with Wood River after uncovering "irregularities" in certain transactions.

HEDGE FUNDS: THE MONEY POURS IN



The ballooning of the hedge-fund business has brought more SEC enforcement, but the number of cases is still modest given the size of the industry. Over the past five years the number of hedge funds has doubled, to more than 8,000, and the assets they manage have likewise doubled, to $1 trillion, according to Hedge Fund Research Inc. in Chicago. During the same period, the number of SEC cases against hedge funds has risen from two in 2000 to 19 last year. There have been 15 so far in 2005. A new SEC rule goes into effect in February that requires hedge-fund managers to register with the agency. But even advocates of regulation concede that mere registration won't do much to deter fraud, and skeptics in the industry warn that it could give some investors the false sense that they don't have to do their own homework. SEC Commissioner Paul S. Atkins, a Republican who opposed the new rule, said in a speech in New York last month that the agency has "neither the resources nor the expertise to oversee all of the potential new registrants."

At least one reason Wood River ran into trouble was Whittier's risky decision to buy a huge stake in Endwave Corp., a small Silicon Valley maker of wireless-communications gear. Investors got wind of the investment in late September, says Ron S. Geffner, an attorney at Sadis & Goldberg who represents Wood River shareholders. "My clients are concerned, given the concentration of the fund's position in an individual security," he says. Their concern was justified: Endwave shares were plunging. Since mid-July the stock has declined 76%, to 13. Wood River's 39% stake in Endwave is now worth $56 million. In its lawsuit, Lehman says it was hired to help Wood River buy an additional 800,000 Endwave shares before the transaction went awry. Endwave CEO Edward A. Keible Jr. says he can't explain the stock's fall and didn't know about Wood River's big stake until the afternoon before the hedge fund disclosed it in an SEC filing on Oct. 7.

RELENTLESSLY UPBEAT REPORTS

ANOTHER GROUP OF investors in an offshore fund Wood River runs learned in late September that members of the firm's management had abruptly quit, says Scott M. Berman, an attorney at Friedman Kaplan Seiler & Adelman who represents the investors. Berman says his clients tried unsuccessfully to retrieve their money but couldn't contact Wood River. Neither Berman nor Geffner would identify the investors they represent.

Apart from its hedge funds, Wood

Elements Of the Sell

Promotional materials for hedge-fund firm Wood River made impressive claims, but a closer look reveals danger signs and apparent deceptions

PERFORMANCE

■ Wood River said it consistently beat major stock indexes by large margins, a difficult feat given its tiny staff.

PEOPLE

■ The firm stressed its employees' Wall Street pedigrees, but most appear to have held relatively modest analyst positions.

INVESTMENT STYLE

■ Wood River boasted of its sophisticated methods, but beneath the bluster it claimed to employ nearly all investment styles: "technical" and "fundamental," "qualitative" and "quantitative."

AUDITORS

■ The marketing literature listed a firm American Express as Wood River's outside auditor, but that company says it didn't audit the hedge fund. Similarly, a firm listed as book says it didn't work for Wood River.

NOBODY HOME Whittier's new abode near Ketchum

r managed $75 million for the much r Millennium Partners hedge fund lew York. Millennium, which has t $5 billion under management, d its money out of Wood River re- y, says a person familiar with the sit- n. But that person wouldn't be specific.

ntil the past few weeks, Wood River telling a relentlessly upbeat story t outperforming well-known stock xes such as the Standard & Poor's stock. The firm engaged no fewer six outside promoters to market its e funds. One, Snug Harbor Capital, material to potential investors via e- as recently as Sept. 12, announcing Wood River had beaten the S&P 500 e month of August. Jason Okie, the Harbor rep who sent the an- cement, didn't return phone calls or ils from *BusinessWeek*. Fyzul Kahn, executive of Silver Leaf Partners a brokerage that has done work for Wood River and is affiliated with Snug Harbor, says institutional investors, not fund promoters, bore responsibility for checking hedge-fund credentials. "It really is their responsibility to dig very deeply," Kahn says. "If more institutions do that, there won't be the need for more regulation."

R

ver claimed in Morgan Stanley f its two prime ut that's not rding to a miliar with the

Wood River's claimed investment returns were all the more impressive given the tiny team of analysts listed as its staff in some promotional materials. The firm sought to reassure prospective investors by also listing as its "independent auditors" American Express Tax & Business Services Inc. and NAV Consulting as its bookkeepers. But those firms say investors were misled. In the "past five years we have not had an audit relationship" with Wood River, says Deborah Ely-Lawrence, a spokeswoman for RSM McGladrey, a unit of H&R Block Inc. that bought the American Express division earlier this month. Nav Gupta, president of NAV, which is in Oak Brook, Ill., says: "We have never even done any business with Wood River."

EARLIER SCRAPES WITH THE LAW

JOHN WHITTIER, THE SON of Ronald J. Whittier, a former executive vice-president at Intel Corp., worked as a media and communications analyst at Donaldson, Lufkin & Jenrette from 1991 to 1997. The younger Whittier formed Wood River in 1997 to manage family money and launched his first hedge fund six years later. There are no complaints or disciplinary actions on his record with the NASD. But even before he got into hedge funds, Whittier had run into legal tangles. In April, 2002, investment bank Credit Suisse First Boston sued Wood River in New York state court over a botched stock transaction similar to the one that prompted Lehman to sue. The CSFB lawsuit was settled out of court. In October, 2002, Wood River's landlord in San Francisco sued the firm for failing to pay rent for three months. That suit was dismissed. And from 2002 through 2004, the state of Idaho filed four tax liens against Whittier totaling $267,156. It couldn't be determined how those liens were resolved. "Those things in concert really made us feel ill at ease," says Randy Shain, executive vice-president at First Advantage CoreFacts, a New York research firm that vetted Wood River for two potential investors this summer. Shain urged his clients to steer clear.

Now, in addition to the SEC, the California attorney general's office is looking into Wood River's actions, a spokesman for the prosecutor says. On Oct. 10 the two outside members of the board of directors of Wood River's offshore fund met without the board's third member, Whittier, to begin the process of ousting him and firing Wood River as the fund's manager, according to a person familiar with the matter.

South of Ketchum, a luxurious new flagstone house sits on property Whittier owns. No one was answering the door on Oct. 11, and it isn't clear whether the hedge-fund manager and his family will ever get to move in. ■

–With Amy Borrus in Washington, D.C., and Nanette Byrnes, Emily Thornton, and Roben Farzad in New York

HOUSING

WHERE A SLUMP WOULD HURT MOST

Hardest hit will be areas whose job growth is tightly tied to construction

THE DECADE-LONG HOUSING boom may not be over yet, but it's showing the first signs of slackening. Prices are off their peaks in a few markets, such as Manhattan; the rate of price increases has slowed in hotbeds such as California and Florida; and houses are staying on the market longer. Meanwhile, Americans' finances are so stretched that they're actually spending more than they earn—the savings rate has turned negative. Housing affordability is already at a 14-year low. And the Federal Reserve, fearing an outbreak of inflation, keeps jacking up short-term interest rates, gradually hiking borrowing costs for both builders and buyers.

HOUSING WATCH

SPILLOVER EFFECT

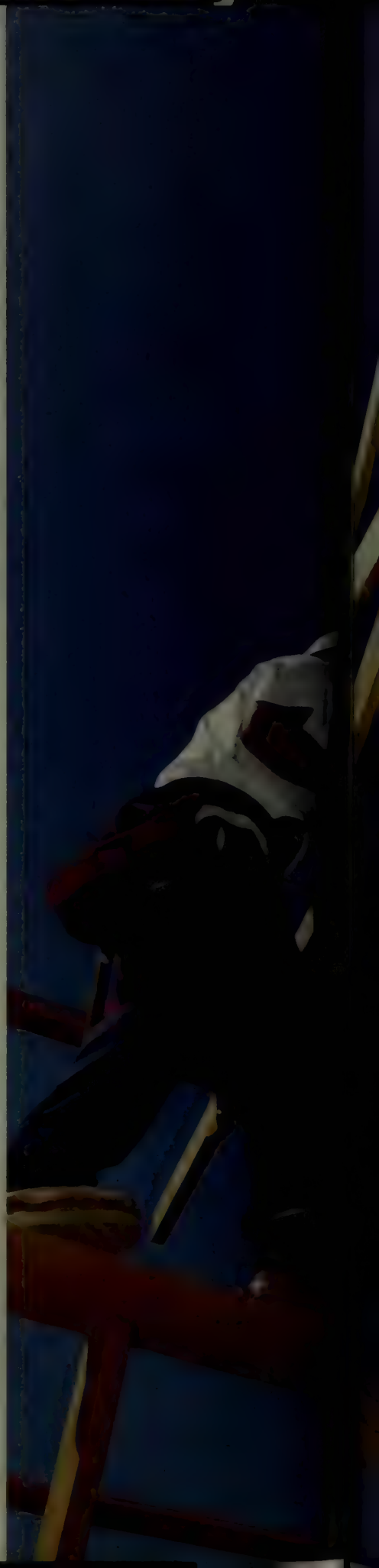
THAT'S RAISING A crucial question: If the housing market turns south, where is the economic damage likely to be the greatest? Places where prices fall a lot will feel the hit, of course. But the greatest economic impact may not come where prices slide the most. Instead, the regions that see the most pain probably will be those where homebuilding has been a major source of new jobs. A decline in housing could accelerate job losses in the entire local economy, as happened in Los Angeles in the early 1990s, when aerospace layoffs and an ensuing housing slowdown led to a 10% decline in overall employment.

Housing matters so much because it has powerful spillover effects. A pair of just-completed studies by the National Association of Home Builders estimate that building 100 single-family homes generates about 350 jobs for a year, 280 of which are local.

The most vulnerable spots, according to a new analysis by *BusinessWeek*, include the Riverside-San Bernardino (Calif.) region—the so-called Inland Empire east of Los Angeles—San Diego, Phoenix, and Las Vegas. In each of these areas new jobs in construction accounted for over 20% of total payroll growth in the past year, vs. a national average of 10%. This measure counts more than just housing construction. But often the construction of other things, such as roads, schools, and malls, follows the building of houses.

In the East, regions that depend heavily on construction employment for growth include Tampa-St. Petersburg and greater Baltimore. In Newark, N.J., and in the nearby wealthy New Jersey surburbs of New York, rising construction employment is partially masking a decrease in other kinds of jobs. Patrick J. O'Keefe, CEO of the New Jersey Builders Assn., says housing starts are running at their highest since 1988 even though the state economy is in a lull. "In the face of a slowdown, it's hard to say which other sectors of the economy would step up to maintain current employment levels," says O'Keefe.

Surprisingly, some of the areas that have seen the biggest runup in housing prices aren't overly vulnerable to a homebuilding slide. Pricey metro New York, for example, is below the national average for new jobs in construction over the past year, with only 8%. Washington, D.C., is right at the national average, with 10%, Miami is at 7%, Boston 11%. Why so low? Construction in these coastal cities has been constrained by severe zoning restrictions, along with a shortage of open land. While these factors drive prices up, they make local economies less dependent on construction for growth.



AXEL KOESTER

RIVERSIDE
Building buoys the entire local economy

Other regions would also come through a housing downturn relatively unscathed. Most Texas cities, for instance, are doubly insulated from a downturn. Housing price hikes been moderate, and construction is a small part of payroll growth: 2% in Dallas, 9% in Houston, and –2% in San Antonio, where construction employment has fallen.

FORMER CITRUS AND DAIRY FARMS

CONTRAST THAT WITH housing's role as an engine of growth in Southern California's Riverside and San Bernardino counties, which stretch east to the Arizona and Nevada borders. Thanks to inland prices that are far cheaper than those along the coast—median-priced properties run about $100,000 less than those farther west—construction is hopping. Subdivisions are being erected by the score in former citrus groves and dairy farms. In the more populated western portion of Riverside County, homebuilding is proceeding so quickly that a regional fee on new homes to fund new roads has raised more than $200 million in the last 2½ years alone.

While construction by itself accounts for 33% of new jobs in Riverside and San Bernardino, that share reaches 39% when jobs in lending, real estate commissions, renting, and leasing are included. And it's not just roofers and real estate agents who are finding work plentiful. Also raking it in are small businesses catering to the trend, such as Taylor's Appliance in Riverside. The family-run retailer has added 16 new employees in the past five years, bringing the total to 48.

Nor is the construction-related job boom solely a West Coast phenomenon. Across the country, in the Baltimore-Towson (Md.) metro area, construction jobs grew 3.7% over the past year even though open land is far more sparse than out West. Not surprisingly, related industries are also soaring. The Maryland Association of Mortgage Brokers, for instance, has swelled to 1,500 members, more than triple the number a decade ago.

Regions that are heavily dependent on housing for employment growth will suffer more than most when a downturn comes. And there's no doubt that a reversal in the market will come eventually. Nationally, the economy's dependence on housing is worrisomely heavy. Since the beginning of 2000, residential investment—i.e., the construction and remodeling of homes—has grown 32% after inflation, more than double the 14% growth of U.S. gross domestic product. Economy.com Inc. chief economist Mark M. Zandi calculates that one-fourth of America's economic growth since 2000 is due to housing.

Builders in fast-growing areas such as Riverside-San Bernardino say they expect housing to remain healthy because of strong pent-up consumer demand. While that could turn out to be true, it's also the kind of talk that is heard in every boom. Technology companies said the same thing in the late 1990s right before corporate spending on technology nose-dived. What housing has given to some metropolitan areas, it can just as well take away. While construction helped buoy the economy through the 2001 recession, it dragged down the overall economy in the more typical 1990-91 recession. From the first quarter of 1990 through the first quarter of 1991, inflation-adjusted residential investment fell 19%, vs. a decline of just 1% for overall GDP.

Falling home values are no fun anywhere. But if you want to know which metro areas will really take it on the chin when prices stall out, look for the ones whose jobs depend on it. ■

–By Peter Coy in New York, with Paul Magnusson in Washington and Christopher Palmeri in Los Angeles

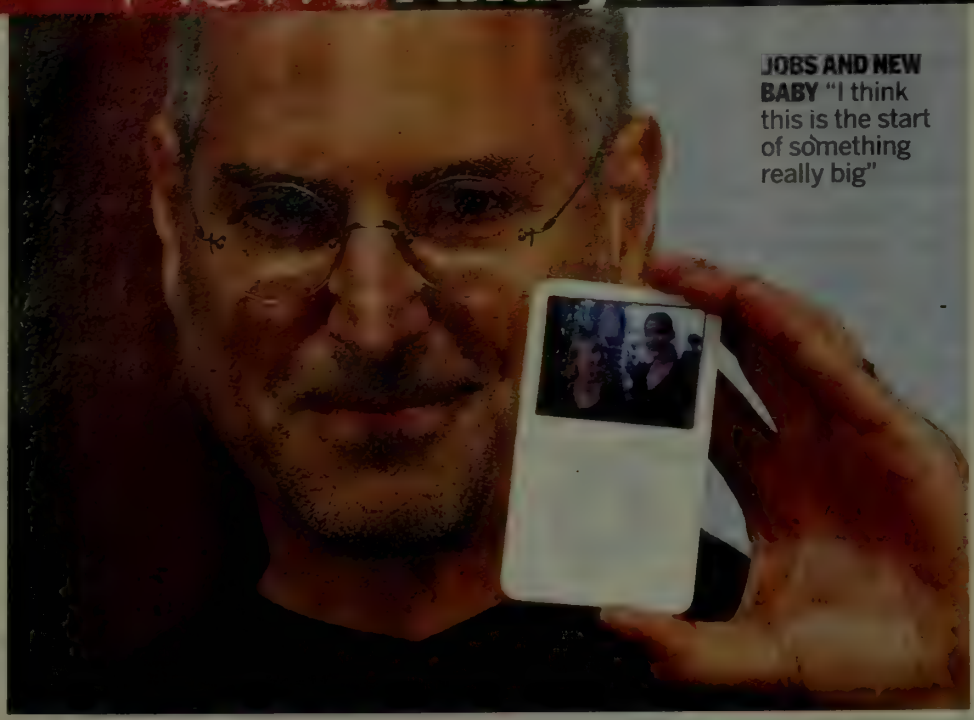
Fueled by Construction

Some metro areas where building accounts for a large chunk of new jobs

	CONSTRUCTION AS A SHARE OF TOTAL EMPLOYMENT GROWTH*
Riverside-San Bernardino, Calif.	33%
San Diego	31%
Phoenix	25%
Oakland	24%
Las Vegas	22%
Los Angeles	22%
Baltimore	21%
Portland, Ore.	15%
Tampa-St. Petersburg	13%
Atlanta	13%

*August, 2004, through August, 2005
Data: Bureau of Labor Statistics, *BusinessWeek*

BusinessWeek online For data on construction jobs for the top 50 metro areas, go to www.businessweek.com/extras



JOBS AND NEW BABY "I think this is the start of something really big"

CONSUMER ELECTRONICS

HOLLYWOOD HOLDS ITS BREATH

The iPod—and Disney's blessing—could create a mass audience for video on the go

WHEN STEVE JOBS unveiled the much-anticipated video iPod in San Jose on Oct. 12, it was immediately clear that Apple Computer Inc.'s latest gizmo will not transform movies the way the iPod and iTunes have revolutionized music. At least not right away. The new iPod, which has a bigger color screen and more capacity, plays short clips and TV series. And Apple has already started selling music videos and episodes of five Walt Disney Co. TV shows, including *Desperate Housewives*, for $1.99 through its iTunes Music Store.

But there were no movie moguls on hand to help Jobs unveil an online store for full-length features. Selling movie downloads is a lot more complicated than selling singles and albums. Studio bosses continue to fret about piracy, and they are loath to give up a distribution model that allows them to release the same movie over and over in different formats.

That's not to say Apple hasn't again stolen a march on its rivals. Along with the video iPod, the company unveiled a slimmer iMac with a remote control that allows people to use the new computer as a home entertainment appliance. And the Disney deal could lead other TV studios to offer content for $1.99. "Only Apple could have brought this together," says Van Baker, an analyst with Gartner Inc.

Still, the day when movies will be downloaded to iPods likely remains far off. Disney chief Robert A. Iger appeared at the Apple event and mused about the potential for the Net to "distribute more content to more people, in more places, more often." But studios are terrified of the digital piracy rampant in music. Apple has had no success convincing them to adopt the Fairplay di tal rights-management technology us in iTunes. Apple did agree, however, r to allow people who buy videos TV shows to burn even a single or DVD.

Besides, studios have more to lose th the music industry's top labels did wh they cut their landmark deal with J back in 2001. While Hollywood suffe through a funk this summer, the stud are in better shape than their mu brethren, thanks largely to a decades- distribution model that lets studios films many times over—first via the b office, then as DVDs, and finally by selli the broadcast rights. As such, studios balking at shuttering these release "w dows" by letting Apple immediately lease their latest hits. Even Disney wo make its TV shows available on iTu until a day after they air.

HURDLES AHEAD

THERE ARE TECHNICAL constrai too. Using Apple's updated iTunes so ware, customers can download an ho long TV show in 20 minutes. At that r a full-length movie would take half hour. And analysts say it would consu half a gigabyte of storage space—or gigabytes-plus, if the movie was shot i high-definition version. As a result, perts say online movies will remain a t niche until U.S. consumers get speed broadband connections, slicker ho networks, and beefier hard driv "Broadband needs to connect to pre display devices in the living room, not j to PCs," says Jim Ramo, CEO of mo download site Movielink.

Jobs is well aware of the hurdles, wh explains why the new iPod is a baby s to get a foothold without spooking studios. But he may be betting that H lywood will soon be ready to cut a d Disney's willingness to let Apple sell TV shows is a sign that compromise m be in the air. And Iger has hinted t down the road, Disney may collapse "windows" distri tion model. "I th this is the start something re big," Jobs s "Sometimes the f step is the hard one." Apple riv take note. ■

–By Peter Burro with Cliff Edwa in San Mateo, Ca and with Ron Grover in Los Ang

DEN MASTER The media-friendlier iMac

Get in the groove.

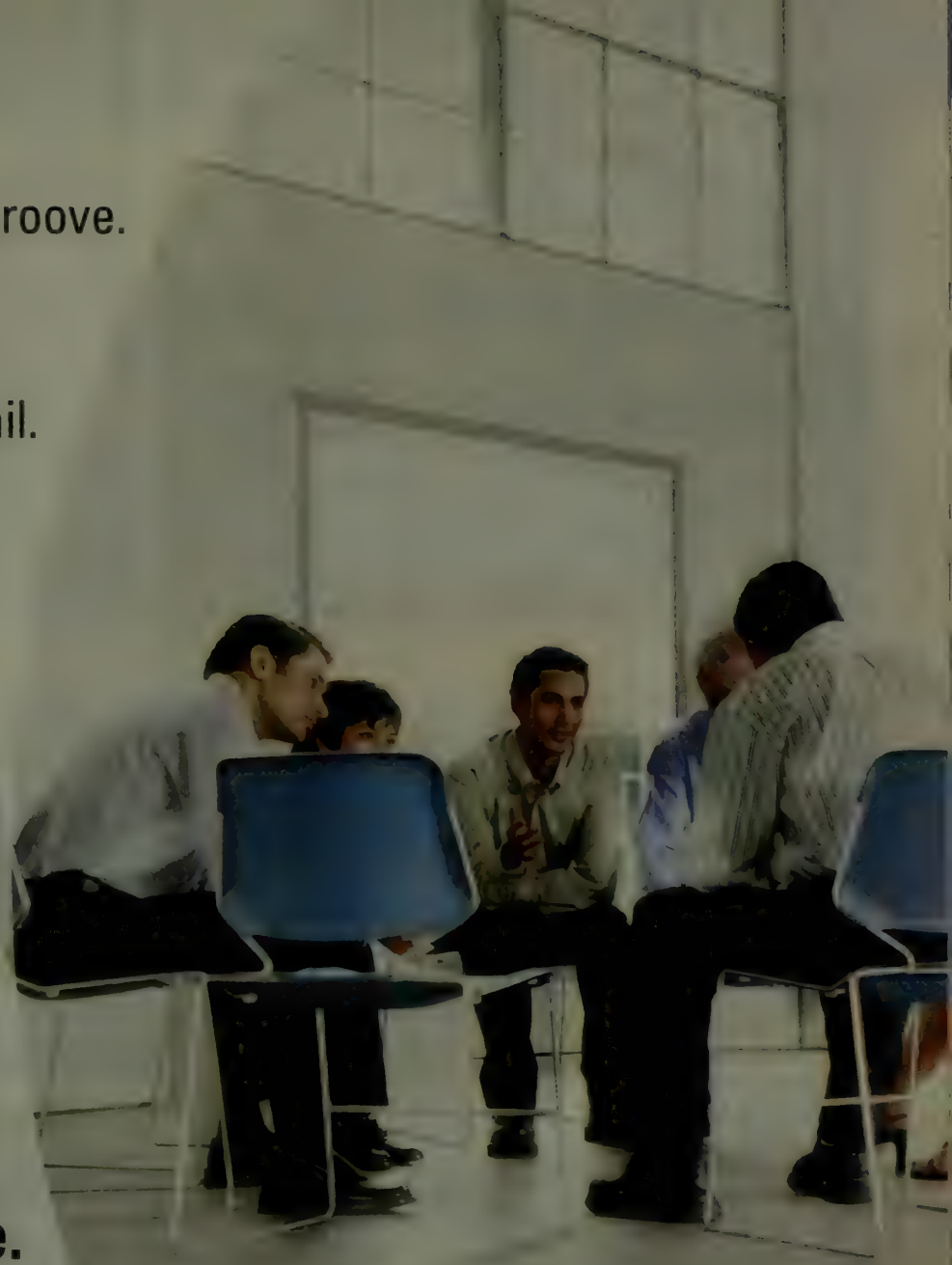
Get it scanned to e-mail.

Get your office humming.

Get it in high impact color.

Get motivated.

Get it done.



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AUTOS

DELPHI: A HELLUVA BARGAINING CHIP

GM bets the ailing parts maker will win big labor savings—and it can follow suit

DELPHI CORP. HAD BARELY filed for bankruptcy on Oct. 8 when all eyes turned to General Motors Corp. It's not hard to see why. In the weeks leading up to Delphi's announcement, many analysts had figured GM would never allow its former parts unit to file for Chapter 11. Doing so meant the already troubled auto maker could inherit up to $11 billion of Delphi's pension and health-care obligations. Even worse, a bankruptcy judge could force GM to pay more for some of the $14 billion in Delphi parts that it buys each year.

But GM is clearly gambling that a Delphi bankruptcy is well worth the risk. As Delphi Chairman and Chief Executive Robert S. "Steve" Miller Jr. closes plants that sell parts to GM, the auto maker can buy those components more cheaply elsewhere. More important, Miller will likely wrest major concessions from the United Auto Workers—ranging from cuts in wages and retirement benefits to sharply higher employee contributions to health care and an end to the industry's costly practice of keeping laid off workers on the payroll for years. Whatever deal he gets could become a road map for talks between GM and the UAW, which must ink a new contract by October, 2007.

If the stakes for Delphi are high, they are another order of magnitude at GM. Its North American operations have already lost $2.5 billion this year. Corporate activist Kirk Kerkorian, whose Tracinda Corp. on Oct. 12 boosted its stake in GM to 9.9%, is increasing his pressure on management and may request a board seat. And the auto maker has been selling off assets, with much of the money going to fund pension and retiree health-care benefits. GM badly needs a new compact with labor. Getting that from a balky UAW is by no means certain. But as Miller told *BusinessWeek*: "[GM is] headed down the same Chapter 11 path as Delphi unless there is dramatic change in their staggering legacy labor burden."

But cutting labor costs alone won't be enough. That's why the market is abuzz with rumors that the carmaker is looking to unload more a sets. Sources close to Kerkorian say the b lionaire sees a cash hoard and saleable a sets that could be liquidated, with procee being used to speed up a restructuring. T company already unloaded its 20% equ stake in Fuji Heavy Industries Ltd., whi makes Subaru cars, on Oct. 5. Now t Street is speculating that GM is consideri selling off chunks of its wholly owned Ge eral Motors Acceptance Corp. and eventu ly its 20% stake in Suzuki Motor Corp. or small piece of Isuzu Motors Ltd. One muc discussed asset: GMAC's Residential Capi Corp., which makes home mortgages und the brand name ditech.com. In downgra ing GM's debt, credit rating agency Standa & Poor's said on Oct. 10 that the turm from Delphi's bankruptcy makes it "mo likely" that GM will sell "substantial" inte ests in GMAC and ResCap.

Such a move could well make sens Both units stand to lose value if GM does separate them from the growing financi distress in its auto unit. GMAC already paying higher interest rates to fund lending because its parent's credit ratin fell to junk levels in May. And ResCap

LET'S TALK Delphi's Miller (inset) and UAW members in Pontiac, Mich.

A Road Map for GM?

How union concessions at Delphi could help its former parent

JOBS Laid-off UAW workers get up to 95% of take-home pay while awaiting a new assignment. Delphi hopes to ax the benefit. Were GM to do the same now, it would save $750 million a year.

MEDICAL UAW workers pay just 7% of their health-care costs. Delphi could force its workers to pay 27%—what its salaried employees are paid. That could allow GM to push for a similar plan that would save it at least $1 billion a year.

PENSIONS To limit its pension obligations, Delphi wants to end its traditional defined-benefit plan for future hires and offer them 401(k) plans instead. GM's pension is fully funded now, but the costs of supporting ever more retirees with a shrinking workforce could force it to shift to 401(k)s for new hires as well.

WAGES Delphi needs to cuts wages, which are 60% higher than the supplier-industry average. GM faces less pressure, since its wages are in line with what Toyota and Honda pay.

ır bonds yield 1 percentage point more ın those of rival Countrywide Financial rp., says bond research firm Gimme edit Publications.

Of course, this isn't the ideal moment for re sale. Potential buyers could try to take vantage of the company's distress and ve hard bargains. Instead, GM could ıdually shrink GMAC to take cash out to severance and retiree benefits. "But y're not going to throw good money af- bad if the union won't meet them part y," says Glenn L. Reynolds, CEO of editSights Inc., a New York research firm.

YING LAID-OFF WORKERS

E UAW HAS ALREADY said it will cut deal to lessen GM's rapidly rising alth-care bill, including boosting co- ys. But if the auto giant's financial po- on worsens, workers could be forced swallow a dramatically less generous n. GM wants union workers to pay same 27% of their health costs as its aried workers. That, say executives, ıld save well over $1 billion a year.

The big question is whether the con- sions Delphi wins in bankruptcy will the groundwork for GM to win similar W givebacks. Miller says he's deter- ned to end the benefit that pays fur- ghed workers up to 95% while they ait a new assignment. GM will need to ı some of the same concessions if it pes to reduce labor costs. About 5,000 rkers are drawing the bennie now, ting GM $750 million a year. Miller plans to end defined-pension benefits new hires at Delphi and replace them h a 401(k) plan, allowing the company limit how much it contributes to the ısion pot each year. GM's pension is y funded, but the costs of supporting r more retirees with a shrinking work- ce could prompt the auto maker even- lly to demand that the UAW accept 1(k) plans for its new hires, too.

With a bankruptcy judge in his cor- , Miller will likely get the union con- sions he's looking for. It won't be so y for GM without that threat. If a ve of new GM vehicles sells well over next 18 months, says UBS analyst bert Hinchliffe, "then the UAW will that things are looking up." And if I builds up its cash reserves by selling ıjor assets, the union could have yet other reason to balk. But the status o at GM is clearly not an option. "As g as you're burning the furniture, it ys warm," says Miller. "But at some ınt you run out of furniture." ■

–By David Welch in Detroit, with David Henry in New York

LEICESTER Britain's PowderMed is developing needle-free vaccines

BIRD FLU

NEW VACCINES FOR A PANDEMIC

Using DNA, vast amounts could be made quickly. But will the drugs work?

IF DR. JOHN BEADLE, CHIEF medical officer at British biotech startup PowderMed Ltd., is right, the U.S. and the rest of the world are making a big mistake. Sometime in the coming years a deadly strain of influenza will strike. If the bird flu that has already killed more than 60 people in Asia and is spreading to Europe mutates into a something that can jump from person to person, the result could be a global pandemic: millions of people dead. Fearing the worst, public health authorities worldwide are vying to stockpile anti-viral drugs. But there aren't enough of them to go around, and they may not work all that well, anyway.

What's needed is the ability to quickly make vast amounts of a vaccine. That's why President George W. Bush met with CEOs of the six major vaccine makers on Oct. 7 to try to prod them into boosting their capacity. But health experts agree that more production alone isn't the answer. Today's 1950s-era manufacturing method requires growing flu viruses in millions of chicken eggs, and it takes nine months or more to make a batch. Says Beadle: "The pandemic will have come and gone before we have the vaccine. That is what shocks me."

So his company and others are working on speedier, more modern alternatives. One promising route is growing the virus in vats of cells. Chiron Corp. is in late-stage trials with a vaccine made from such cell-grown viruses. The method is also being developed by leading flu-vaccine maker Sanofi Pasteur Inc. and others, and promises to cut months off production times.

"A MODEL FOR BIODEFENSE"

BEADLE HAS A more radical solution—vaccines constructed from DNA. Trials, set for next year, are needed to prove that such vaccines can actually protect people from flu. But if the approach works, it would be a major advance. "DNA has some real advantages for a pandemic vaccine," notes University of Rochester professor Dr. John Jay Treanor, who tests flu vaccines. "There is no need to handle live viruses, and there are no complicated purification steps." Instead, the vaccine is largely comprised of a few genes from the virus. Once in the body, the genes tell cells to make viral proteins, which stimulate an immune response.

Such a vaccine is "trivial" to manufacture, says Erik A. Henchal, former commander of the U.S. Army Medical Re-

search Institute of Infectious Diseases. Different genes could be swapped in, enabling rapid production not only of vaccines against new flu strains, but also against other threats. "I'm interested in encouraging this going to trial for flu because I see it as a model for biodefense," says Henchal. Beadle figures that once the technology is proven, his company could make enough vaccine for all Americans in a kitchen-size factory in just six weeks.

Given the promise of DNA vaccines, others, such as Chiron and Merck & Co., have tried to make them. Typically, however, experimental versions have failed to generate a sufficient immune response. PowderMed's data look far better, researchers say. One reason is the delivery method. Tiny gold particles are coated with vaccine and shot into the skin at supersonic speeds. "They know what they are doing," says Treanor.

It sounds simple, though major hurdles remain. The next step is proving DNA vaccines work against regular flu—and that takes money. So far, the U.S. Health & Human Services Department (HHS) has awarded $100 million to Sanofi to make a vaccine against avian flu using eggs and $97 million to develop cell-culture production facilities. HHS is about to hand out another award, but it has told PowderMed it has been dropped from consideration. Too unproven.

Cell-culture vaccines aren't proven, either, retorts Beadle: "Even if there were only a 5% chance that DNA vaccines offer the answer, wouldn't you want to put significant resources behind it to find out?" Others agree—and Congress is making noises about intervening. "We need to learn that we can't keep doing business as usual," says Dr. Gary J. Nabel, director of the Vaccine Research Center at the National Institutes of Health. "We should have been working on these new technologies, like DNA vaccines, 10 years ago." Maybe the threat of a global pandemic will correct that mistake. ■

–By John Carey in Washington

THE STAT

6

The number of weeks it might take to ramp up production of a DNA-based vaccine, vs. at least nine months using current technology

Data: PowderMed Ltd

THE INTERNET

BIG MEDIA, LITTLE BLOGOSPHERE

There aren't yet enough quality pages to satisfy advertisers' hunger for a blog presence

JASON MCCABE CALACANIS had an enviable problem. Advertisers eager to reach niche audiences were banging on his door. But the CEO of Weblogs Inc., a collection of 90 blogs, didn't have enough front-page space to sell them. Calacanis huddled with investors to devise a plan to scale up the business. Instead, on Oct. 6, he sold Weblogs to America Online Inc. for a reported $25 million.

AOL is hardly the first mainstream media company to plunge into interactive Web journals known as blogs. Over the past year a who's who of major publications (including *BusinessWeek*) have launched their own. Within a day of the Weblogs deal, Gawker Media, which operates a smaller stable of sites, agreed in a partnership with Dutch publisher VNU to launch five European-language versions of its gadget blog, Gizmodo. The two deals come six months after The New York Times Co. paid $410 million for About.com, a collection of some 500 niche sites similar to blogs.

CALACANIS He'll start loads more blogs with AOL cash

Why the push? While few blogs generate much revenue, they introduce a new, promising micromedia model. Blogs are cheap, easily updated, and can focus on a niche market with passionate followers—an advertiser's dream. Toronto's *Globe & Mail* has dispatched a blogger-reporter to Pittsburgh to cover a single hockey star, 18-year-old rookie sensation Sidney Crosby. "You can build a massive Web site and audience around one hockey player," says Dave Morgan, CEO of TACODA Systems Inc. an advertising-technology company. What's more, blogs feed word-of-mouth on the Web. Comments on blogs can pro advertisers with feedback, and circulate quickly among readers.

But for all their promise, blogs just getting started as an ad platf While Calacanis is now mum numbers, in July he celebrated a Google-placed ads on his sites top $2,739 in one day, which would adc to $1 million over a year. Those ads a big part of Weblogs' business— $1 million is barely a rounding error major media companies. Calaca frustration has been that he c expand fast enough to meet advert demand without mak large investments in te nology and staff.

So he's is counting on to give him the resources freedom to run a blog em from his base in Sa Monica, Calif. The for publisher of the *Silicon A Reporter* has proven adep quickly zeroing in on ta audiences and hiring p time bloggers from all o Jim Bankoff, the AOL e who negotiated the deal w Calacanis, wants Weblogs develop loads of new blc including sites with au and video channels. "Micropublish is the next wave," he says.

The question is whether the b industry will spring from big media upstarts. Nick Denton, the founder Gawker, predicts media companies stifle new models that challenge th core business. "Big media remarkably resistant to change," says. Calacanis' Santa Monica b factory looks to be a prime test case.

–By Stephen Baker in New Y

BusinessWeek online To download a pod interview with Jason Calacanis, go to businessweek.com/search/podcasting.htr

Kim came with:

A retirement plan that relied solely on 401(k)s and IRAs.

Kim left with:

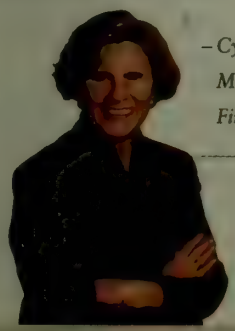
A retirement plan that uses all the pieces of her financial life to help her retire the way she wants.

A variable annuity designed to work with her specific retirement needs.

A strategy to provide a steady flow of income she can use to travel once she stops working full time.

Frequent portfolio reviews to monitor progress toward her goals.

used to be 401(k)s and IRAs were enough. Today, retirement is different. It's not defined y being 65 anymore. Some of my clients want to keep working. Others want to retire sooner. With Total Merrill℠, bring together Merrill Lynch solutions that can help all their assets work together and give them more choices. Because at's what the new retirement is all about — the freedom to live exactly how you choose."



– Cynthia Hewitt, Merrill Lynch Financial Advisor

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THE INTERNET

BETTER LOVING THROUGH CHEMISTRY?

An offshoot of Match.com is taking a "scientific" approach to matchmaking

LET'S FACE IT, DATING IS a drag. There was a time when we thought the computer was going to make it all better. As a result, one out of every 100 Internet users now posts a personal ad. But most of us learned the hard way that finding someone who shares our love of film noir and obscure garage bands does not a perfect match make. So why not try science instead? In other words, can the length of your index finger or your ability to judge spatial relationships land you Mr. or Ms. Right?

O.K., you have your doubts. But who knows; it may be worth a try. On Oct. 11, the largest online dating site, Match.com, launched Chemistry.com, a new service that attempts to use neuroscience to come up with the ideal match for its subscribers. The centerpiece is a lengthy questionnaire designed by Helen Fisher, an anthropologist at Rutgers University whose recent book, *Why We Love: The Nature and Chemistry of Romantic Love*, lays out the biology behind our romantic choices. Answer the questions, pay your subscription fee, and Match.com promises to grace your inbox with possibilities that, you hope, won't be dates from hell.

So how does Chemistry.com do its magic? By studying brain scans and behavioral studies, Fisher theorizes that the type of person who can ring your bell is hard-wired into your neurons. Embedded in each of our brains is a "love map," she says, that guides our choice of a mate. Chemistry.com's questions are meant to decipher that map. It then runs each profile through a proprietary computer algorithm to find that special someone who will light up your neurons. And you thought romance was in the stars.

Chemistry.com is just the latest in a series of online profiling services. Fast-growing dating sites like eHarmony.com, True.com, and PerfectMatch.com require subscribers to spend up to an hour filling out questionnaires. EHarmony even rejects potential subscribers whose profiles don't meet their mainstream criteria. Ouch.

Dating sites can't be too choosy, though. Although some 22 million Amer-

icans subscribe to online dating sit
JupiterResearch estimates that indus
revenues will total a relatively mod
$500 million this year. And with ma
users tiring of constantly searchi
through ads for "The one," growth
slowing dramatically—to 9% annua
from 19% in 2004 and 77% in 2003.

PULLING THE TRIGGER

SO FAR THERE'S little evidence that p
sonality profiling works any better tha
blind date set up by your so-cal
friends. But online daters seem to go
it. After all, writing up your own sa
pitch is torture. "Casual daters have
worst personal ads ever," says David
Evans, editor of the Web magazine *Onl*
Dating Insider. "They sign up at 11 p
after they've had a couple of beers w
their single friends. Of course people
better off taking these tests."

As for Chemistry.com's scientific clai
Fisher says they're legit. The typical dat
site finds matches based only on simil
ties. But "we're trying to get at some of
very subtle ways that people complem
each other," says Fisher.
Chemistry.com asks s
head-scratchers as "Wh
solving a problem, do you
nore secondary informati
and focus on the goal?" A
yes, it asks you to meas
your index fingers (stud
show their length is an in
cator of how much test
terone you were exposed
in the womb).

The Web site also ai
to get online daters to p
the trigger and meet. Y
know the drill: Two peo
exchange endless e-ma
but never actually
together. Chemistry.c
prods matchees into
quick date.

It hasn't worked for E
J. Scofield, 31, of Denve
yet. She did meet two m
while testing the serv
this summer. Did lightni
strike? No, but she's not g
ing up. "It was obvi
there was at least so
compatibility," she sa
Will this software find l
for Scofield and milli
like her? Let's just hope
neurons know what the
looking for. ■

–By Catherine A
in New Y

Chemistry.com Wants to Know...

... Just about everything. Match.com, with its new Web site, is turning to personality profiling. A few sample questions:

- When solving a problem, do you ignore secondary information and focus on the goal?
- Do you have an opinion on everything?
- Do you think competition is healthy?
- Do you think that it is important to do the right thing, even if it hurts others?
- Do you prefer to work alone rather than managing a team of co-workers?
- Do you admire people who know their own mind and are very decisive?
- Do you get impatient when people don't make their point quickly?
- Do you wait for someone to prove themselves before you trust them?

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EDITED BY MONICA GAGNIER

HEADLINER

NEIL FRIEDMAN

TICKLE ME, NEIL

Can the man who taught Elmo to hokey pokey help Barbie get her groove back? In a pre-Christmas shakeup, Mattel promoted Neil Friedman, the 58-year-old chief of its Fisher-Price preschool unit, to head of all its major brands, including the company's struggling Barbie business. Friedman, a toy industry veteran, has won high marks from analysts and industry insiders for bringing out new electronic learning products and a string of furry Elmo dolls that sang and danced to popular songs.

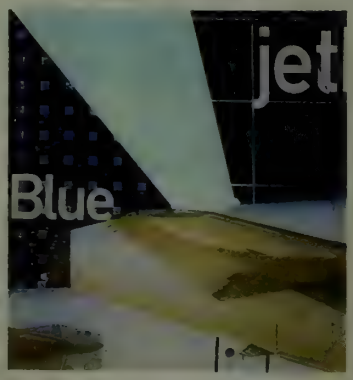
This is the second major reorganization in two years by Mattel Chairman and Chief Executive Robert Eckert. A Kraft Foods veteran, Eckert has proven more adept at cutting costs at Mattel than at thwarting competition from Barbie's edgier rivals, the Bratz dolls. Barbie's worldwide sales have fallen for seven consecutive quarters. Expect Friedman to spend even more time with the toy elves coming up with clever ideas for next Christmas.

–Christopher Palmeri

ROUGH PATCH AT REFCO

Phillip Bennett, ousted CEO of the global futures titan **Refco,** is facing securities fraud charges and his former firm is wrestling with a crisis in investor confidence. Bennett, forced out on Oct. 10, was charged two days later with hiding a debt that ranged as high as $545 million. Investigators from the U.S. Attorney's office for the Southern District of New York and other agencies suspect he and others inside and outside the firm repeatedly moved the debt among Refco units, a firm he controlled, and a New Jersey hedge fund to hide it for years. The alleged maneuver came to light just two months after Refco went public at $22 a share. Refco said Bennett recently paid off the debt. Neither Bennett nor his lawyer returned repeated calls for comment. Refco's shares fell 62%, to $10.85, on Oct. 12, in the wake of the scandal.

JETBLUE PROPULSION



What airline crisis? **JetBlue Airways** announced a major expansion of service on Oct. 11, including flights from Boston to five new cities and expanded service out of its New York base at John F. Kennedy International Airport. To cap it off, the low-cost carrier is offering $25 one-way flights between New York and Boston until Dec. 14—although the tickets must be bought by Oct. 20. After that, prices on the New York-Boston route will range from $40 to $120. The goal: get a bigger chunk of the market from major carriers like **US Airways** and **Delta Air Lines.** New York-based JetBlue is now the nation's fastest-growing airline.

A NEW DREAM TEAM FOR AOL?

Comcast is joining the list of suitors for the once-denigrated **America Online** unit of **Time Warner.** The nation's largest cable operator and broadband provider has agreed to team with search powerhouse Google in a possible bid for a minority stake in the Dulles (Va.) outfit, sources say. Attracted by the opportunity to use content from both AOL and Google, and the chance to apply Google's search technology to its TV and broadband programming, Comcast didn't take long to respond to Google's invite during the first week of October to talk with AOL, say sources. AOL has also been talking to Microsoft about merging some of its operations with MSN. This is tricky because the software giant owns about a 5% stake in Comcast.

A FOG CLEARS FOR PFIZER

Pfizer dodged a bullet. On Oct. 12, a British court rejected drugmaker **Ranbaxy Laboratories'** effort to launch a generic version of Pfizer's $12.5 billion blockbuster drug, Lipitor. Although Pfizer lost on a second patent, that loss will not cut the protected life of the cholesterol-lowering drug in Britain. As result, the drug will be free c generic competition in Britain through November, 2011. Pfizer is awaiting a ruling on a similar case in th U.S., which accounts for 60% of Lipitor's sales.

ET CETERA...

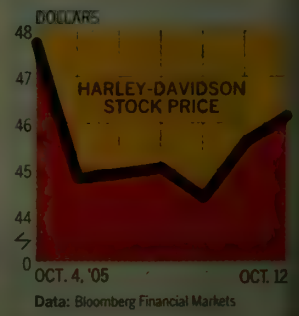
>> **Martha Stewart Living Omnimedia** will team with **KB Home** to offer designer housing.

>> **Microsoft** will pay **RealNetworks** $761 million to drop claims that the giant tried to thwart its business.

>> **Bridgestone/Firestone** will pay **Ford Motor** $240 million to settle claims related to the 2000 recall of defective tires

CLOSING BELL

Shares of Harley-Davidson moved ahead 4%, to $46.15, in the two trading days ended on Oct. 12, driven by strong third-quarter profit growth. Net income rose 16% on a 10% sales gain. Still, Harley cut its 2006 earnings outlook, citing economic uncertainty.



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DITED BY RICHARD S. DUNHAM

Keeping America Safe—From Foreign Buyouts

RARE COMMODITY ON CAPITOL HILL—bipartisanship—is emerging ithin the Senate Banking Committee. And that has business orried. The reason? There is a budding consensus to tighten les allowing U.S. companies to be sold to foreigners. That uld nick corporate interests and damage relations with trading tners, particularly China, Congress's ef target.

Fueled by concern over China National shore Oil Corp.'s aborted bid for Unocal rp. this summer and fear of widespread inese purchases of U.S. brands, GOP and mocratic lawmakers agreed at an Oct. 6 ring that an obscure interagency panel, Committee on Foreign Investment in U.S. (CFIUS), needs more teeth and ser congressional scrutiny. "We cannot rifice our safety for economic gain," says verick Banking Committee Chairman hard Shelby (R-Ala.).

Critics say CFIUS, which iews the national security pact of foreign bids for . assets, lets too many ls through. It "looks like a rmat operation," fumes Richard D'Amato, chair- n of the U.S.-China Eco- nic & Security Review nmission, a congressional chdog panel.

A Government Account- lity Office report released September found flaws in system, from a narrow nition of national security reluctance to launch in- tigations that might drive vn a company's stock and l foreign investment. vmakers are mulling some fixes to the cess, which is kept hush-hush to protect le secrets. A bill introduced by Senator nes M. Inhofe (R-Okla.) would prod the el to consider a deal's effect on American nomic security and the need for energy l other critical resources. Inhofe's bill also tains a controversial proposal to give ngress a veto over foreign mergers. On House side, Armed Services Committee irman Duncan Hunter (R-Calif.) and ranking Democrat Ike Skelton (D-Mo.) have said they may want to strengthen CFIUS.

PRYING EYES Shelby wants deals to face greater scrutiny

The bipartisan rumblings could easily rise to a roar. "It's a major economic issue that's bubbling below the surface right now and will burst forth on the next CNOOC deal that comes down the pike," says Todd M. Malan, president of the Organization for International Investment, which represents U.S. arms of foreign corporations. With Beijing awash in dollars from its trade surplus with the U.S. and in need of recycling those greenbacks, deals—and conflict—seem inevitable.

Changes will come over the opposition of business and the Bush Administration, which think the process works well now. Companies also fear retaliation against their U.S. operations overseas. A coalition of 11 major trade groups, from the American Petroleum Institute to the Securities Industry Assn., has written Shelby to argue that CFIUS thoroughly reviews deals and imposes conditions to protect national security needs. "If the U.S. is viewed as becoming hostile to foreign investment, we put at risk U.S. firms who operate in foreign markets and the 5.3 million jobs in America insourced by foreign companies," the September 27 letter said.

As globalization boosts the number of deals and the parameters of national security expand from weapons to Internet backbones and energy production, pressure will build on politicians to act. For foreign buyers of U.S. assets with any link to national security, life is about to get a lot harder. And that's making business queasy. ■

–By Stan Crock

CAPITAL INSIDER

WAS FRIST JUST CLEANING HOUSE?

New details are emerging about Senate Majority Leader **Bill Frist's** financial transactions this year. The Tennessee Republican, whose sale of stock in the hospital corporation founded by his family is being investigated by the Securities & Exchange Commission, shuttered his own 2000 senatorial campaign account this summer after writing a check for $75,000 to cover losses the committee suffered when it invested much of its proceeds in the stock market, *BusinessWeek* has learned.

Frist's campaign account played the tech bust and lost

Frist's campaign lost a bundle when the tech bubble burst, and political adviser Alex Vogel acknowledges that its initial million-dollar mutual fund investment withered over the years. Frist backers say the senator's attempt to clean up the old mess is evidence that he was engaged in financial housecleaning in advance of a possible '08 Presidential race at the time he sold the HCA Inc. stock—not trying to dump HCA holdup in advance of a bad earnings report.

Lawmakers are permitted to gamble campaign cash in the market, but few do—largely because campaigns put a premium on liquidity. And Vogel says a future Frist campaign may play the market again. "Senator Frist, like a lot of folks, believed, and continues to believe, that the stock market is a good investment," he says.

–By Eamon Javers

GERMANY

GOLDMAN'S GERMAN REVOLUTION

Companies that went bankrupt were always liquidated–until the firm took over Ihr Platz

ANXIOUS EMPLOYEES at Germany's huge retail drugstore chain Ihr Platz (Your Place) were braced for the worst a year ago. The $840 million company, based in Osnabrück in northern Germany, had seen its sales shrink by over 40% in five years and losses mount as a new generation of family managers blundered and successive chief executive officers failed to stem the decline. The 125-year-old retailer was technically insolvent—a condition that would normally doom a German enterprise to liquidation.

But an unlikely rescuer appeared on the scene: Goldman Sachs Group Inc., the U.S. investment-banking giant. Ihr Platz's woes had hit the radar screen of Goldman's London-based restructuring group, a 30-strong team formed two years ago to develop a European business investing in distressed debts and turnarounds. By January of this year, a Goldman-led consortium had snapped up all of Ihr Platz's $144 million in bank debt and, working with the shareholders' trustees, sent in experts from Alvarez & Marsal, a New York turnaround specialist. When discussions with other creditors bogged down, Goldman bought out the remaining bank debt and in May pushed Ihr Platz into insolvency.

Goldman's maneuver would hardly raise an eyebrow in New York or London. But in Germany, it was revolutionary: The American firm is pioneering Germany's first large case of a Chapter 11-style restructuring under a little-used 1999 law—a test case that could well spur many more such workouts and galvanize industrial overhauls in Germany. "American and British hedge funds use insolvency as a strategic tool to implement a turnaround. Unlike Germans, they don't see bankruptcy as a stigma but as a viable alternative if out-of-court restructuring fails," says Leo Plank, an attorney and restructuring advisor at Broich, Bayer, von Rom in Frankfurt, noting that the sale of distressed debt has soared in the last 12 months.

With a speed that has astonished German insolvency experts, Ihr Platz's restructuring is now headed for final creditor approval on Nov. 17. The vote, less than six months after the May 31 insolvency filing, will put the company back on solid financial footing, end the insolvency proceedings, and save 8,100 jobs out of 9,000.

Bouncing back from insolvency under Chapter 11 of the U.S. bankruptcy code may be a well-trod path for troubled American companies. But bankruptcy laws across Europe don't grant companies protection fro creditors in order to restructure. So a leg declaration of insolvency typically ends liquidation. Germany modified its law 1999 so insolvent companies could wor out revival plans with creditors and kee management running the company i stead of losing control to a court admi istrator—a clause similar to Chapter 11

Workout, U.S.-Style

How Goldman Sachs engineered Germany's first big bankruptcy turnaround

- Bought out the distressed bank debt of insolvent drugstore chain Ihr Platz (revenues $840 million) in late 2004
- Filed for insolvency in 2005 under a little-used 1999 law that allows German companies to work out their debt instead of liquidating
- Extended $9 million in fresh credits
- Recruited a turnaround management team from Alvarez & Marsal that sold unprofitable stores and overhauled logistics, saving 8,100 out of 9,000 jobs
- Will submit final restructuring plan to creditors on Nov. 17

Data: BusinessWeek

OVERCOMING SKEPTICISM

NO ONE DARED TO TRY such a workou strategy, however. Germany lacks turn around experts with experience in com plex bankruptcy restructurings. And giv en banks' and entrepreneurs' tradition reluctance to admit insolvency and suffe the stigma of failure that it carries, mo German bankruptcy cases are not file until it is too late to rescue the compan "It makes me furious, because I know lot of companies could be saved," sa Horst Piepenburg, president of the Inso vency & Restructuring Division of th

PRUNING Krishnan won approval to close 80 of 813 stores

rman Bar Assn. and a co-manager in Platz's restructuring. He figures that least 15% of Germany' s 40,000 annu- nsolvencies could emerge intact from olvency, saving thousands of jobs.

Global capital markets may finally be ggering a change. As Germany's banks w increasingly eager to unload their tressed debt—they traded $30 billion t last year—and investors scout out the d of premiums that restructuring of- s, players such as Goldman are lining to engineer turnarounds in exchange private-equity type returns of at least % to 20%—and up to 100% or higher in me cases, experts say. "Germany is go- g to be one of the strongest markets for tructuring in Europe for the next few rs," says Simon Mansfield, managing ector for Goldman's London-based re- ucturing group.

It was clear from the start that Ihr Platz ld survive, says Alvarez & Marsal senior ector Michael F. Keppel, now chief financial officer of Ihr Platz. He and Sankar Krishnan, managing director of Alvarez & Marsal's London office and currently CEO of the retailer, saw a strong brand they could revive by shutting profitless stores, overhauling inefficient logistics, and boosting sales.

A PR agency was hired to get the word out that Ihr Platz would be reborn

Before the May 31 insolvency filing, however, talks among creditors bogged down and labor leaders resisted shuttering the 80 of 813 stores that Krishnan and Keppel wanted to close. "There was a lot of skepticism," recalls Heiko Waldmann, Ihr Platz's personnel manager. "We had seen a lot of consultants. They earned a lot of money and didn't perform."

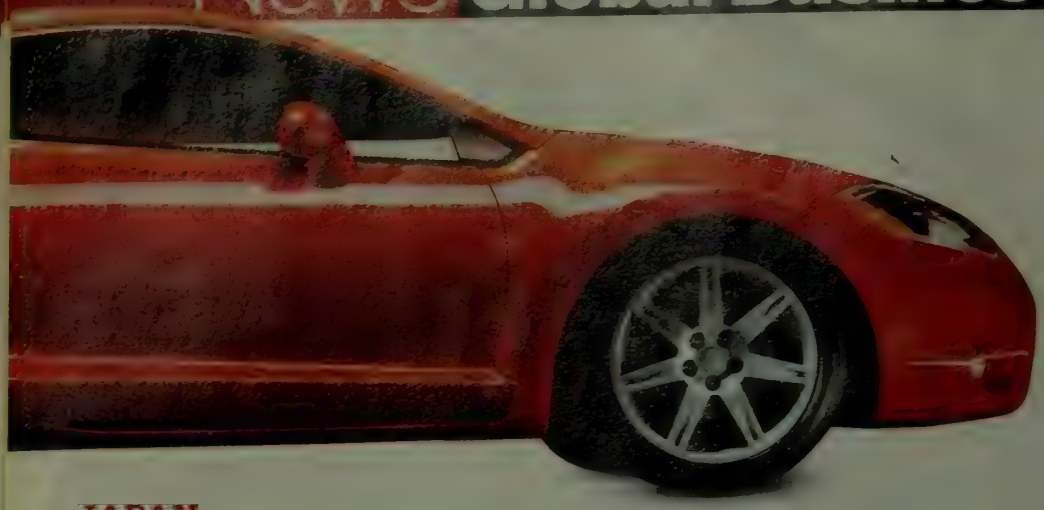
But once Ihr Platz filed for insolvency, the restructuring moved into high gear. A court order allowed Krishnan and Keppel to close quickly 80 stores and a warehouse. Squabbling suppliers agreed within six days to sell their debt to Goldman, paving the way for fresh credit lines. Germany's bankruptcy code also includes state coverage of workers' salaries for a three-month interim period. That allowed Ihr Platz to channel cash to vital creditors.

Krishnan also paid close attention to image-making. In May, left-leaning politicians had kicked off a national uproar by accusing international investors of preying on German businesses like "locusts." So Krishnan hired a London public relations firm to get the word out to employees, creditors, customers, the mayor of Osnabrück, and even the Prime Minister of Lower Saxony that Ihr Platz meant to save jobs instead of liquidating. "I told them: 'Don't use the word insolvency, use the word restructuring,'" says Krishnan. The agency prepared letters, Web-site material, a hotline, and television and radio interviews to spread the message.

Beyond closing stores and managing PR, Krishnan and Keppel worked on new products, alluring promotions, and improved presentation. Krishnan, a retail turnaround specialist, buffed advertising circulars and offered lifestyle-driven promotions such as artists' supplies or backyard grill equipment. Krishnan is also rolling out a line of organic cosmetics and foods.

Krishnan and Keppel are now aiming to match 2004 sales this year, hit breakeven by yearend, and turn a profit in 2006. Goldman, which aims to hold on to the retailer for a while before selling out, is eager to find more candidates for restructuring. The rescue of Ihr Platz won't erase the German aversion to insolvency overnight. But it's likely to spur a slew of imitators. ■

–By Gail Edmondson in Osnabrück



BUZZ MACHINE The $20,000 Eclipse has drawn attention to the brand

JAPAN

MITSUBISHI ZIPS PAST THE SCRAP HEAP

Smart marketing, new models, and cost cuts could avert a financial meltdown

FREE GAS—THAT'S ONE WAY to fill up a showroom. And that's just the come-on Mitsubishi Motors Corp. has been using in the U.S. since late September. Buy a Mitsubishi, get free gas for a year. "It has energized the entire dealer organization," says Dave Schembri, an executive vice-president at Mitsubishi Motors' U.S. subsidiary in Cypress, Calif.

Gas Comes Standard (the name of the Mitsubishi promotion) is one of the latest signs of life at a carmaker long left for dead. Although much smaller than General Motors Corp. or Ford Motor Corp., Japan's Mitsubishi, with annual sales of $18.5 billion, can match those big companies disaster for disaster. Sales in the U.S. and Japan, its two key markets, plummeted 30% in 2004 and the company posted a $4.7 billion loss for the year ended in March. That was more than its earnings for the past 15 years combined. Zero hit models meant zero profits. A meltdown seemed imminent as Mitsubishi burned through cash reserves and partner DaimlerChrysler cut off fresh funds and reduced its stake from 37% to 12.9%.

By the time Osamu Masuko, a 30-year veteran of trading house Mitsubishi Corp., took over as president of Mitsubishi Motors in January, many pundits were preparing its obituary. But the carmaker may be slowly edging back from the brink. "We know what measures we need to take to improve the company," says Masuko.

The auto maker has moved quickly to rebuild under its new management. In May, it rolled out the 3.8-liter, $20,000 Eclipse sports coupe, a muscle car with a sleek, arching shape and V6 engine that has generated much-needed buzz. August sales in the U.S. rose 2.1% on the year—the biggest jump in two years. Back in Japan, sales leaped 23.5% in August after Mitsubishi began offering free inspections covering 3.4 million cars earlier this year. That was designed to address fears growing out of a scandal involving recall cover-ups that dates back to 2000. All this has helped the company's share price shoot up 146% this year—most of that in the past six weeks.

Despite all the good news, Mitsubishi is expected to post a half-year loss of $637 million in November, much better than the enormous loss of a year before but still pretty scary. Y Masuko pledges return to the bla in the second ha and limit the fu year loss to $560 million on a sharp reco ery in sales. Not only is the Eclipse h Masuko points out, but sales are expect to be strong for other new models such a new midsize SUV called the Outland That 2.4-liter vehicle goes on sale Oct. 17 Japan and is due out in late 2006 in t U.S. The company also plans to slash cos 15% by early 2007 and has alread trimmed 6,500 jobs over the past year.

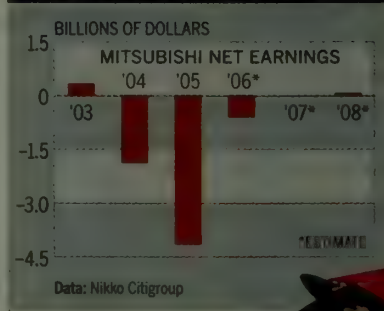
BREATHING ROOM

MITSUBISHI HAS some breathing roo to refocus thanks to a $2.6 billion lifeli thrown to the company in January by ot er members of the Mitsubishi *keiret* That has eased concern the auto mak was headed for the junkyard. With th backing, Masuko has set the stage f repositioning Mitsubishi toward pe formance-oriented sedans, midsize SUV and trucks like the $19,180 Raider picku launched in September in the U.S. Th six-seater, the only imported pickup in i class with an optional V8 engine, mar Mitsubishi's return to midsize trucks aft a 10-year absence.

Masuko predicts Mitsubishi will b making a profit by the end of next yea But can it compete in the long term wi rivals such as Honda Motor and Toyo Motor Corp.? "Mitsubishi has a lot work to do to keep up with those [two] says George Brue, general sales manag at Rick Case Mi subishi in Roswell, G But free gas shou help. ■

–By Ian Rowley i Tokyo and Christoph Palmeri in Los Angele with Rishi Chhatw in Atlant

A LONG ROAD TO PROFITABILITY



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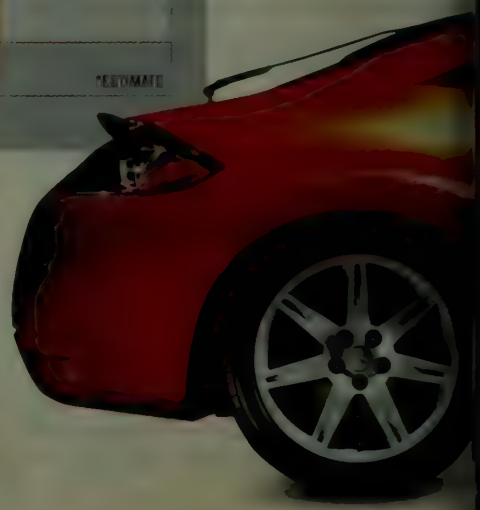

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SOUTH KOREA

BEHIND SAMSUNG'S BRIGHT LIGHTS

Wild success, but how much does one family's tight control cost shareholders?

IN MANY RESPECTS, SAMSUNG Group is one of Korea Inc.'s leading lights. It is the country's largest conglomerate, with businesses in everything from insurance to industrial chemicals accounting for 20% of Korea's exports. And its flagship, Samsung Electronics Co., has transformed itself from a second-tier producer of TVs and appliances into a design powerhouse and the world's undisputed king of memory chips.

When it comes to corporate governance, though, Samsung doesn't shine quite so brightly. Sure, Korea's *chaebol*, or conglomerates, aren't as murky as they were a few years back. But continuing problems were highlighted on Oct. 4 when a Seoul court convicted two Samsung executives of breach of trust for helping pass control of the group from Chairman Lee Kun Hee to his children—at the expense of other shareholders. The two were given suspended jail sentences but are appealing the decision. Lee family members haven't been charged with any wrongdoing in the affair and declined to comment for this story.

The two defendants were Park Ro Bin and Her Tae Hak, the current and former CEOs of Samsung Everland, an unlisted company that operates Korea's largest theme park. The court found them guilty of allowing Lee's children to buy 64% of their company in 1996 for less than $10 million—an amount prosecutors said was 9% of the market value. Everland controls unlisted Samsung Life Insurance, which in turn owns 7.3% of crown jewel Samsung Electronics. That stake plus other holdings gives the Lee family control of 16% of Samsung Electronics—enough to call the shots at the company. "Samsung is both the pride of Koreans and a reminder of the primitive capitalist system in the country," says Kim Sang Jo, a Hansung University economist who heads a shareholder activist movement.

HER TAE HAK
Convicted of breach of trust

Funny thing is, Samsung Electronics is one of Korea's most transparent companies. Foreign investors own 54% of its shares, and they have shown confidence in the elder Lee and CEO Yun Jong Yong. "The management is very focused," s Chen Gu, an analyst at DuPont Capi Management, a Delaware money man er that owns $80 million in Samsu Electronics shares. She says that in long term, the group is better off w strong leaders such as Lee and Yun, w can invest in the future without frett over quarterly results.

That system, though, creates plenty potential for abuse. Lee and his fam hold less than 5% of shares in group's companies but wield near-a solute influence through a web of cro holdings. Lee vets all key appointmen including the CEOs of 61 member co panies, which means that loyalty to family and the promotion of its intere can easily take precedence over the w fare of other shareholders.

THE KOREA DISCOUNT

OTHER *CHAEBOL*, meanwhile, have do a better job of cleaning up their act. for instance, two years ago set up a ho ing company that oversees LG Electron and 16 other affiliates. That has boost transparency by clarifying ownersh though even LG isn't exactly a paragon corporate virtue: When credit-card issu LG Card Co. ran into financial proble last year, other group companies poni up nearly $900 million to bail it out.

The slow progress of *chaebol* refo means the "Korea discount" lives That's the drag on Korean share pri because of concerns that profits mig be milked by controlling shareholde (as well as worry over the political ris posed by North Korea). Korean sha trade at an average of 9.3 times th projected 2006 earnings, 30% bel the Asian average and the lowest mul ple in the region, Merrill Lynch & says. "If Samsung Electronics moved headquarters to New York and list there, its shares would probably trade double the current price," says one fo eign fund manager who asked not to identified. That's not likely to happe Still, Samsung—and even the Lee fan ly—would be well served if the gro were to stay right where it is but ma its governance as good as its wor beating products. ■

–By Moon Ihlwan in Seoul, w Lauren Young in New Y

Wide Web
How the Lee family controls Samsung Electronics

54%	13.3%	31%	7.3%	16%
The Lees' stake in Samsung Everland	Everland's stake in Samsung Life Insurance	Total stake in the insurer controlled by the family	Samsung Life's stake in Samsung Electronics	Stake in Samsung Electronics controlled by the Lees

Data: Center for Good Corporate Governance, June, 200

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DAVID J. O'REILLY
CHAIRMAN & CEO
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We can wait until a crisis forces us to do something. Or we can commit to working together, and start by asking the tough questions: How do we meet the energy needs of the developing world and those of industrialized nations? What role will renewables and alternative energies play? What is the best way to protect our environment? How do we accelerate our conservation efforts? Whatever actions we take, we must look not just to next year, but to the next 50 years.

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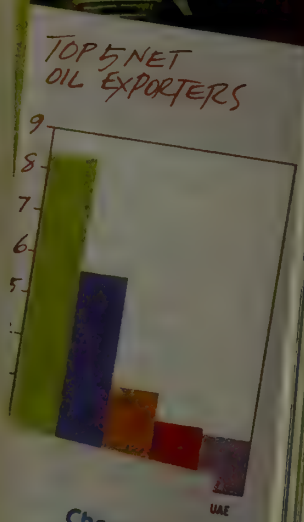
Dave



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EDITED BY ROSE BRADY

Looking for New Ways To Budge China

IN ITS ECONOMIC DEALINGS WITH CHINA, the Bush Administration has frequently come across as being obsessed with the country's currency, prodding Beijing in public and private to change its fixed-rate system. In July those efforts finally bore fruit when China scrapped its policy of pegging the yuan to the dollar and allowed its currency to appreciate a modest 2.1%.

Now, as Treasury Secretary John W. Snow and Federal Reserve Chairman Alan Greenspan prepare for meetings in Beijing on Oct. 16-17, the Administration is putting forward a more nuanced strategy for tackling the trade deficit with China. It still wants the yuan to rise. But it's also pressing Beijing to boost domestic consumption and liberalize its financial markets more quickly, including removing caps on foreign ownership of financial firms. "We take a holistic view," says Treasury Undersecretary for International Affairs Timothy D. Adams. "We're not just focused on one aspect."

Banking Inroads

THE U.S. ISN'T wedded to bilateral pressure, either. Instead, the Treasury is trying to shift some of the heat on China to the International Monetary Fund. In a speech on Sept. 23, Adams suggested the IMF was "asleep at the wheel" when it came to policing the currency policies of its members—a charge IMF officials denied. But if the U.S. can prod the IMF into calling for a yuan revaluation, Washington can keep up the pressure without playing the role of bully.

NUANCED Snow also wants Beijing to liberalize financial markets

The broader U.S. approach reflects economic reality. Currency changes alone were never going to cure the bilateral trade imbalance, which could hit $220 billion this year, vs. $162 billion in 2004. The wider focus also diverts some attention from the currency issue, which has threatened to trigger a major confrontation with China. Many U.S. lawmakers are incensed by what they see as China's policy of keeping its currency low to boost competitiveness. Some want to punish Beijing with tariffs as high as 27.5% on Chinese exports.

If the Treasury can point to progress on other fronts in its dealings with China, it can argue that a trade war is unnecessary. Bank of America Corp. recently got the go-ahead to buy a 9% stake in China Construction Bank, and UBS is taking control of Beijing Securities Co. Adams called China's financial liberalization "a bright spot" but said Beijing should move faster. The Americans want China to promote a credit-card industry by setting up an independent credit bureau. U.S. banks also want China to lower some of the stiff capital requirements imposed on their branches in China.

The risk is that China could misinterpret the Treasury's broader strategy as a sign that the U.S. is content with changes made so far to the yuan. That's not true, a point Snow and Greenspan are sure to stress. "Their job is to convince the Chinese that patience [on the yuan] is not infinite," says Morris Goldstein, senior fellow at Washington's Institute for International Economics.

The real test of the holistic approach could come in November, when the Treasury presents its semi-annual currency report to Congress. It will then have to decide whether to cite China as a currency manipulator and risk giving a green light to Congress to retaliate. U.S. officials are hoping China will use the upcoming meetings to unveil new steps to cut its trade surplus. With President George W. Bush set to visit Beijing in November, another crisis in China-U.S. relations is the last thing Snow & Co. want. ■

–By Rich Miller in Washington, with Brian Bremner in Hong Kong

WRAPUP

SYRIA'S REGIME FEELS MORE AND MORE HEAT

THE CHAIN reaction set off b the assassination of former Lebanese Prime Minister **Rafi Hariri** on Feb. 14 is gaining force. The murder has already been the catalyst for driving the Syrian military out of Lebanon. The latest casualty appears to be **Ghazi Kanaan,** th powerful Syrian Interior Minister and ex-chief of Syria intelligence in Lebanon. Syri authorities say Kanaan committed suicide in his Damascus office on Oct. 12. The question now is whether the fallout will reach all the way to President **Bashar Al Assad.** "This is a landmark event," says Murhaf Jouejati, director of Middle East Studi at George Washington University in Washington. Kanaan "was a very importan person in the inner circle."

Kanaan's death is a sign of growing international pressu on the Assad regime. **Detlev Mehlis,** a U.N. investigator, ha interviewed Kanaan in late September, and it was rumore that Mehlis would finger Syri intelligence operatives, possibly including Kanaan, i report on Hariri's assassinati due on Oct. 25. The inquiry comes at a time when the U.S is toughening its line. On Oct 9, David Welch, Assistant Secretary of State for Near Eastern Affairs, criticized Syri for a list of offenses.

The Bush Administration chiefly is unhappy about Assad's tolerance of Iraqi opposition activities in Syria and his inability or unwillingness to close Syria's borders with Iraq to *jihadis.* Some analysts think the U.S. i now intent on bringing Assad down. Certainly the regime is jittery, and it's not clear Assad is in full control. Kanaan's demise will add to the tension

–By Stanley Reed in Lond

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Wanted: Fed Chief With Foreign Flair

With so much U.S. debt held overseas, Greenspan's successor must be a diplomat

SOMETIME NEXT YEAR, A new Federal Reserve chairman will take Alan Greenspan's seat at the massive mahogany table in the central bank's Washington boardroom. He will look around the room and see his fellow policymakers, including the presidents of the 12 regional Federal Reserve banks, based in such cities as Richmond, Va., Cleveland, Kansas City, and St. Louis—a list that has not changed since 1914.

But wait a minute—in an era of rampant globalization, wouldn't it make more sense for the new Fed chief to be joined around the table by his counterparts from Frankfurt, Beijing, and Tokyo rather than Richmond and Cleveland? The answer is yes, it would make more sense. And no, it's not going to happen.

The next financial crisis, when it comes, is likely to be global in scale, requiring a concerted effort by the major central banks to keep the world economy on an even footing. But no one would seriously contemplate putting Zhou Xiaochuan, Governor of the People's Bank of China, on the Federal Reserve.

Instead, the best alternative is for the next Fed chief to have a deep knowledge of the international economy and the diplomatic skills to bring his fellow central bankers to the table in a crisis. That means the list of potential replacements for Greenspan should be broadened to include such international experts as Michael Mussa, former chief economist for the International Monetary Fund; Manuel H. Johnson, former vice-chairman of the Fed and now an international consultant; and even James A. Baker III, former Secretary of the Treasury and State Depts.

> The next crisis will require joint action by central bankers

During his 18 years at the U.S. central bank, Greenspan tried to stay away from becoming too heavily involved in the global arena, fearing that such involvement might compromise the Fed's independence. But the next chief may find it harder to stay so hands-off. Soaring trade deficits have left the U.S. dependent on foreign capital. And some of the biggest holders of U.S. Treasury securities are foreign central banks, led by Japan and China. "That's the big difference from when Greenspan took over," says Robert D. Hormats, vice chairman of Goldman Sachs International: "Increasingly, U.S. monetary policy is being impacted by policies abroad."

DISASTER AVERTED

IN PAST CRISES, Greenspan was able to act independently, backed up by the most powerful central bank in the world. For example, in 1998 the Fed moved quickly to avert a disaster after Russia's debt default and the near-collapse of giant hedge fund Long-Term Capital Management threatened to bring global financial markets to a standstill. "We were acting as central bank for the world," says Alice M. Rivlin, who was Fed vice-chair at the time and is now at the Brookings Institution.

That's no longer possible. A crash landing of the dollar could trigger a financial meltdown and put the Fed in a quandary: It could flood the banking system with dollars to buoy the financial markets. But that would then run the risk of triggering an even faster fall of the dollar and a sharp spike in long-term interest rates as foreigners dumped their U.S. bonds.

In that scenario, the U.S. could not act as global lender of last resort, as it did in 1998, says Karin Lissakers, a former U.S. director at the IMF, in a paper presented at a recent Institute for International Economics conference. Nor is there any other institution that could easily step into the

le. The IMF is an obvious candidate. But decision-making apparatus is cumbersome and its finances limited for handling mega-crisis like a dollar crash. The Bank International Settlements in Basel, itzerland, sometimes called a club for ntral bankers, could serve as a forum for llective action. But it has no finances of own to contribute.

In the end, what would likely happen is at a small group of central banks, including the Fed, would band together to prop up the global financial system. That approach puts a premium on having a Fed chairman who can collaborate effectively with overseas counterparts to defuse the crisis. The chief would also have to work closely with the Treasury Dept., while being independent enough to reassure skittish foreign investors.

So how do the leading candidates to succeed Greenspan stack up? Most of the attention has been focused on Harvard University professor Martin Feldstein, Columbia Business School dean and *BusinessWeek* columnist R. Glenn Hubbard (page 146), and Ben S. Bernanke, a former academic who heads the White House's Council of Economic Advisers. All certainly have the intellectual credentials as economists to do the job. None, though, has been tested as a global crisis fighter.

But there are other experienced policymakers who have the two key attributes for the job—experience with international financial diplomacy and the ability to get appointed by a Republican Administration. One heavyweight with these qualifications is longtime Bush confidante Baker, who has shown a knack for stitching together international coalitions during times of stress. As Treasury Secretary in the late 1980s, he played a big role in getting the central banks of Western Europe and Japan to help bring down the dollar in an orderly way. Baker has some big minuses, though, including his long history as a top Republican political operative and his age. At 75, he's only four years younger than Greenspan.

Another candidate who might be attractive to Bush is Manuel Johnson, 56, who helped fashion Ronald Reagan's 1981 across-the-board tax cut and 1986 tax reform. Now a global economic consultant, he helped coordinate monetary policy with his counterparts in Europe and Japan during his term as vice-chairman of the Fed from 1986 to 1990.

Former IMF chief economist Michael Mussa is also no stranger to dealing with global crises. His 10-year tenure at the IMF included the 1997 Asian financial crisis and the 1998 Russia debt default. He's now at the Institute for International Economics think tank in Washington. Mussa is known for his irreverent wit, however, which could be a liability in the Fed job.

With his recent choices for the U.S. Supreme Court, George W. Bush has shown a knack for picking unexpected names. He could do a lot worse than choosing a new Fed chief who looks beyond our shores. ■

–By Rich Miller in Washington

A Global Greenspan?

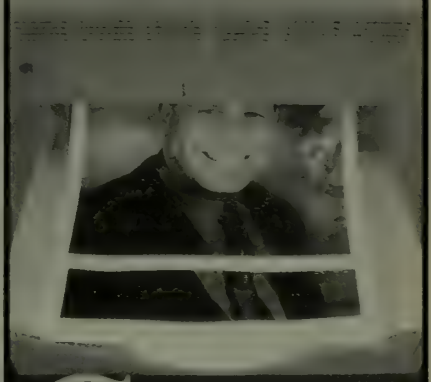
A critical skill for the next Fed hair will be the ability to work losely with central bankers in ther countries in a global nancial crisis. Here are three eople who might fit the bill

JAMES A. BAKER III, 75
As Treasury Secretary under President Reagan, Baker played a key role in fashioning the 1985 Plaza Accord in which the U.S., Japan, and Europe banded together to manage the dollar's decline. ater, as Secretary of State under Bush's ther, Baker helped build the coalition at drove Iraq out of Kuwait. Baker, owever, may be considered too political nd too old for the job.

ANUEL JOHNSON, 56
s Fed vice-chairman from 86 to 1990, Johnson elped coordinate U.S. onetary policy with merica's allies during the ecline of the dollar and e 1987 stock market ash. Like President Bush, he's a big eliever in tax cuts, having been a enior official in the Treasury Dept. nder Ronald Reagan. Now an ternational consultant, Johnson has ose ties to Wall Street.

MICHAEL MUSSA, 61
As chief economist for the International Monetary Fund from 1991-2001, Mussa was a key player during the 1997-98 Asian economic crisis. The well-respected former niversity of Chicago professor also rved as a member of Reagan's ouncil of Economic Advisers.

Paul Orfalea would have a tough time reading this ad.



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Herding Hurricanes

It can't be done yet, but one scientist's computer simulations point the way to tempering fierce weather in the future

EVERYBODY TALKS ABOUT the weather, but nobody does anything about it. Whether or not Samuel L. Clemens ever uttered those exact words, changing the weather is an age-old dream. Egyptian priests, medieval sorcerers, and Native American shamans all had incantations and dances devoted to it. And in Mark Twain's day, the Midwest was crawling with charlatans who claimed they could make it rain.

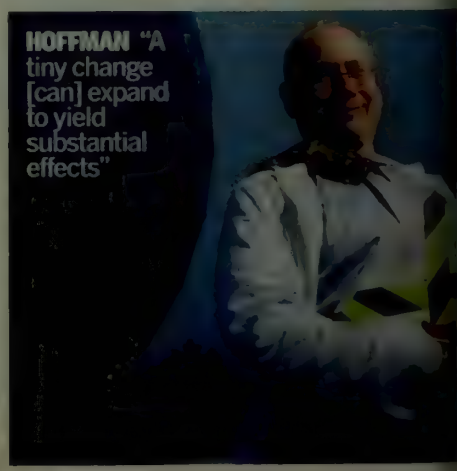
Today, a handful of scientists are taking the idea further. One of them is Ross N. Hoffman, vice-president for research at Atmospheric & Environmental Research Inc. (AER), a weather consulting firm in Lexington, Mass. He predicts that one day it will be possible to tame hurricanes, or at least to steer them away from cities, so they don't wreak havoc on the scale of Hurricane Katrina.

In fact, Hoffman has already achieved that feat—in computer simulations. Using data from Andrew and Iniki, two major storms in 1992, he was able to show that relatively minor atmospheric adjustments could make a huge difference. With Iniki, which slammed into the Hawaiian island of Kauai that September, Hoffman diverted the simulated storm 60 miles to the west by injecting a rise in air temperature of less than two degrees Celsius six hours before landfall. With Andrew, it took an increase of up to three degrees to keep dangerous winds away from Florida's coast. There is currently no feasible way to make such adjustments, but that hasn't stopped Hoffman from exploring the idea in virtual reality.

Hoffman's research dates from the late 1970s, when he was working on his 198 PhD in meteorology at Massachusetts Institute of Technology. His mentor was Edward N. Lorenz, the meteorologist who popularized the so-called butterfly effect in chaos theory with his 1972 talk, "Does the flap of a butterfly's wings in Brazil set

Storm Control

Computer models show that minor tweaks to certain conditions before a hurricane hits might keep dangerous winds at bay—or steer a storm away from land. But even if technically feasible, interventions would be very expensive.



HOFFMAN "A tiny change [can] expand to yield substantial effects"

WATER, WATER Overflow from a lagoon inundates Pensacola, Fla., during Katrina

a tornado in Texas?" (For a decade be- that speech, Lorenz' analogy had n a "flap of a seagull's wings.")

Once I learned about chaos theory," ffman recalls, "I realized it might be sible to make a tiny change at one par- lar time and it would grow and ex- d to yield substantial effects." He nted to base his dissertation on the po- tial for using chaos theory in weather trol but was advised against it. ather modification was—and still is—a chy subject. So it was unlikely he could e enough funds to run all the simula- ns needed to begin uncovering rules that govern the seem- chaos of weather systems. After MIT, Hoffman did weather research at NASA, then joined AER in 1983. But his dream didn't fade. In 2001 he heard about the NASA Institute for Advanced Concepts, which is funded by NASA but serves as an independent hatchery for way-out ideas. The institute coughed up $550,000, and Hoffman began searching for those flapping-butterfly changes. "With Iniki, we tried to find the smallest possible perturbations so that six hours later, the hurricane would end up 100 kilometers off to the west," he says. "You don't want to make huge changes. That would take too much energy."

With today's science, Hoffman's scheme for injecting enough heat to raise a hurricane's temperature by even the smidgen in his simulations is pure science fiction. He envisions orbiting satellites with arrays of giant solar heat collectors that would beam energy down to earth. Hoffman admits that such devices are unlikely to be launched for decades, although solar-power satellites are perennial favorites at NASA and the European Space Agency.

Hoffman urges no action till the physics is better understood

In an October, 2004, cover story in *Scientific American*, Hoffman laid out some intriguing alternatives to orbiting satellites. One is sprinkling rainmaking chemicals on the clouds surrounding a hurricane's eye. By forcing the eyewall to drop some of the warm water that nurtures the storm, it might be possible to deflate menacing hurricanes.

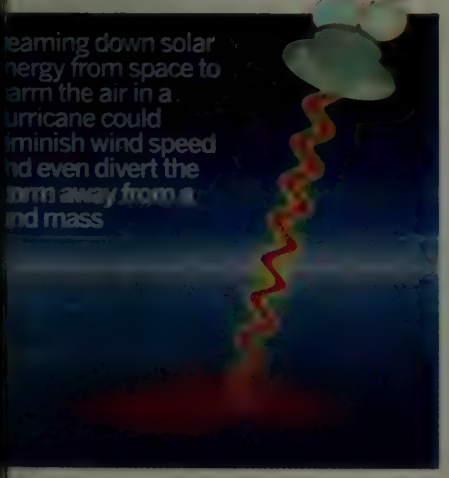
A tactic like this has actually been tested. For 10 years, starting in 1961, the U.S. Navy and federal weather researchers seeded four hurricanes—not the eyes, but the northeast quadrants, which pack the strongest winds. Each hurricane was seeded for two days. After four of the missions, wind speeds reportedly dropped by 10% to 30%. The other four missions were fruitless. Years later, in 1983, advances in hurricane research indicated that seeding the outer regions was doomed from the get-go, and the project, dubbed Stormfury, was terminated.

Undaunted, scientists have now cooked up a new strategy: Prevent a hurricane from soaking up water and energy by coating the ocean's surface. Creating an oil slick by dumping thousands of gallons of biodegradable vegetable oil on the ocean has been proposed by Damian R. Wilson, a researcher at the Met Office, Britain's weather service. When MIT researchers ran some experiments to test the idea, they found that waves break up the slick into small pools, so it probably wouldn't be effective in the heavy seas of an oncoming hurricane.

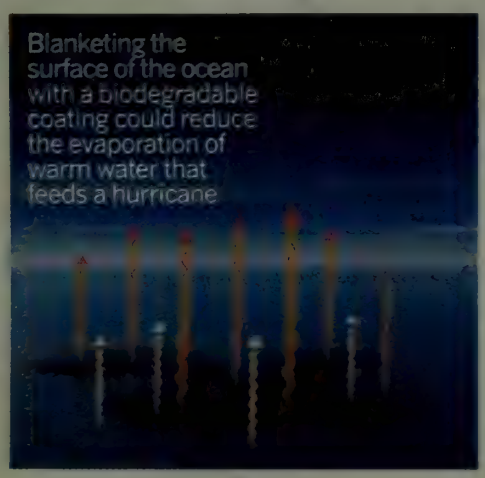
But Hoffman asserts that "things like spraying the surface are worth pursuing." His MIT friends may have missed a key aspect, he argues: "A hurricane sucks in air, so it may be possible to use a surface coating to dry out the air at some distance from a hurricane."

Among weather professionals and amateurs, there's no shortage of suggestions for disrupting or "curtaining" a hurricane. They range from dropping a nuclear bomb to cooling the ocean by towing icebergs into the tropics. The nuke-it solution is sheer folly because it would produce radioactive rain. And cooling the ocean probably isn't possible, either. "It would require a great deal of energy, because water has a high capacity to absorb heat before it begins to warm up," says Hoffman. Besides, a hurricane packs 10 times the energy of the atom bombs that ended World War II, so all the icebergs in the North Atlantic might not do the trick.

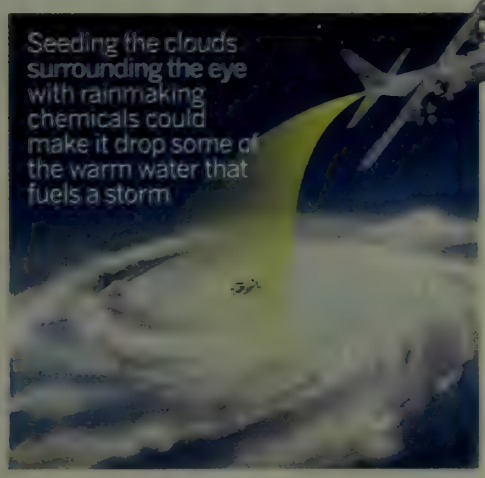
While Hoffman believes that engi-



eaming down solar nergy from space to arm the air in a urricane could iminish wind speed nd even divert the orm away from a nd mass



Blanketing the surface of the ocean with a biodegradable coating could reduce the evaporation of warm water that feeds a hurricane



Seeding the clouds surrounding the eye with rainmaking chemicals could make it drop some of the warm water that fuels a storm

neers will eventually learn how to manage hurricanes. He and many others argue that it should not be attempted until the physics are better understood. Without that, trying to steer a storm like Katrina away from New Orleans might cause it to slam into Florida instead. "If you mitigate a storm in one place, how do you know you're not going to make it worse for somebody else?" asks Bernard J. "Ben" Eastlund, CEO of Eastlund Scientific Enterprises Corp. in San Diego, who has been doing research on modifying severe weather for 20 years. At the same time, Eastlund notes, it's likely to cost $300 billion to clean up after Katrina—just o storm. "Doesn't that tell you it's time fund a serious effort to understand t weather and find some handles to de with this?" ■

–By Otis Port in New Yo

DEBATE

Rainmaking Has Its True Believers—and Skeptics

Weather modification isn't just about giant storm systems. Rainmaking and hail prevention are considered established arts in some countries. China has 35,000 people engaged in weather management, and it spends $40 million a year on alleviating droughts or stemming hail that would damage crops. Russian officials claim to order up clear skies for Moscow's May Day parade. It's done by saturating clouds with dry ice, producing so many tiny droplets that drops can't grow big enough to fall as rain—at least for a while.

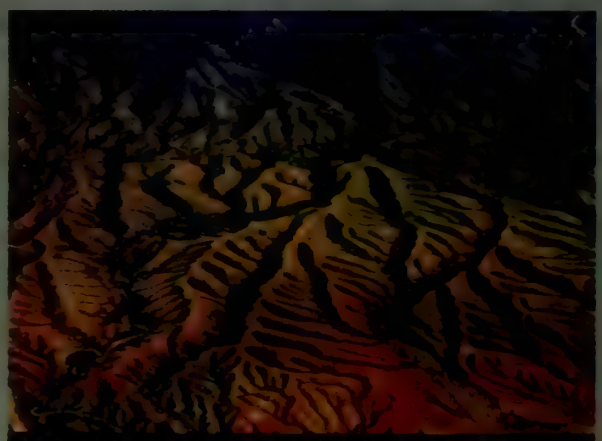
In the U.S., though, there is no clear consensus on how well such techniques work, or if they work at all. In the 1970s the U.S. plowed $20 million a year into cloud-seeding research, but almost all federal funding has since dried up.

Nevertheless, dozens of state, local, and private operations continue in 10 states, including California, Idaho, Nevada, and Utah. Vail Mountain in Colorado and many other ski resorts pay for cloud seeding, and Vail estimates that teasing more precipitation from clouds boosts its snowpack by 15%.

While modern rainmakers and their clients believe the technology works, convincing the skeptics will be difficult. For the statistical proof that science normally requires, the data on weather-modification efforts might need to span 60 years or more—at least two of earth's 30-year weather cycles. Only a few of the cloud-seeding programs, including one in Saudi Arabia and one in Wyoming, are now collecting rigorous data.

Perhaps the most controversial technology comes from Russia and Mexico. In 1996, Russian space and weather-control scientists hooked up with Gianfranco Bisiacchi, then head of Mexico's space efforts, and founded Electrificación Local de la Atmosfera Terrestre (ELAT). Nominal results from the three ground stations set up by ELAT in 1998 were so impressive—rainfall was reported to increase by as much as 30%—that Mexican state governments were soon clamoring for more facilities. There are now 13, with additional ones being installed in Baja California and the state of Puebla.

ELAT claims credit for ending the severe drought in northern Mexico. Since 2000, says Bisiacchi, the amount of annual rain in the region has been "30% to 35% greater than what it was during the 1990s. In fact, the lakes of the region that were dry are now full." When operations in the northern states of Sonora and Chihuahua started in 2004, he adds, most lakes were around 8% full. "We've now gone to levels of 85% to 90%—in just one year."



MEXICO Rainfall has increased 30% in Sonora

ELAT says its technology is more efficient than regular cloud-seeding methods. "Milking" clouds is usually done by sprinkling them with particles of silver iodide. The particles provide a site where the clouds' ice crystals accumulate in clumps too heavy to stay aloft. Bisiacchi and his team take a different tack: They generate charged ions on the ground and point them skyward. That, they claim, fosters clumping on both airborne dust particles and ice crystals touched by a charged ion.

This technology has plenty of skeptics. "Personally, I think it's a hoax," says Roelof T. Bruintjes, a weather-modification expert at the National Center for Atmospheric Research (NCAR) in Boulder, Colo. "It has no scientific basis."

Bisiacchi isn't fazed. "Look," he says, "this is new technology—a new scientific hypothesis. It's the same whenever you try to do something really new." ELAT aims to change the prevailing negativism. The company is now setting up ground stations that will be used for research, including one south of Laredo, Tex. It will host a yearlong test by ELAT's U.S. licensee, Ionogenics Corp. in Bedford, Mass. "We hope to collect enough data to validate the concept that ionization does, in fact, affect the behavior of atmospheric physics within a certain proximity of the station," says Ionogenics Corp. CEO Phillip T. Kauffman.

NCAR's Bruintjes figures that regular cloud seeding will soon turn respectable. "In the next 5 to 10 years, I definitely think we're going to see great changes," he says. New radar technology, advanced computer modeling software, and much faster supercomputers "will provide a whole new view of cloud seeding—and be able to quantify cloud seeding's effectiveness," he maintains.

Rainmaking's potential at one point even tantalized a blue-ribbon science panel convened by the National Academy of Sciences. In its October, 2003, report, the group called for a concerted national research program to settle the dispute over cloud seeding. It hasn't happened yet. The technology is not even on the Administration's long-range radar screen. For the moment, all federal funding for cloud-seeding research is gone.

–By Otis Port

Changing the course of a life starts with one step in the right direction.

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information about the Jackie Joyner-Kersee Foundation visit www.jackiejoyner-kerseefoundation.org or honda.com. ©2005 American Honda Motor Co. Inc.

NO. 1 Dean Dipak Jain (third from left) with students

THE BEST EXE

PHOTOGRAPH BY MICHAEL L. ABRAMSON; DIGITAL IMAGING BY DAVID RUDES/BW

CUTIVE MBAs

With fewer companies footing the bill, students' needs have changed—and winning schools are meeting that challenge

BY LOUIS LAVELLE

EIDI A. VOORHEES had had enough of nonprofits. After more than three years as senior director for the Defense Research Institute, a Chicago association of defense attorneys, she was ready to launch a career in the for-profit world. She knew she would need an MBA, but taking two years off to get one was financially out of the question. So two years ago, at 33, she applied to the executive MBA program at Northwestern's Kellogg School of Management. This way she could continue to work full-time while attending classes every other weekend. But unlike the many executive MBA students who are sponsored by their employers, Voorhees paid the entire $108,000 tab on her own, figuring that a degree from a top-ranked B-school such as Kellogg would pay for itself in no time.

She was wrong about one thing: She never made the switch to a for-profit company. But she was right about another: Less than four weeks after she graduated in June, Voorhees landed a new job as a vice-president with the Institute of Food Technologists, a Chicago-based trade group for food scientists, nearly doubling her pay. She has a lot more responsibility—hired to oversee two departments, she's now in charge of four—and she has already applied teamwork concepts she learned at Kellogg to break down organizational silos. The Kellogg faculty deserve much of the credit, she says. Always available, many of them do outside consulting work that allows them

to bring a real-life perspective to class. "Kellogg has some of the best professors, and the executive program gets the best of the best," says Voorhees. "I can't say there was one class or one professor I didn't learn something from."

With raves like that, it's no wonder Kellogg solidified its hold on the No. 1 spot in *BusinessWeek*'s biennial ranking of the best Executive MBA programs. For the third consecutive time, grads lauded the Kellogg program's emphasis on teamwork and its rich learning environment. The faculty bring a deep theoretical understanding to their subjects, say students, but also a flair for capitalizing on their own company-specific knowledg gleaned from years of consulting work—while weaving in ti students' real-world experience. A high-caliber student b and a staff devoted to working out all the logistical kinks—fr lodging to laptops to gourmet meals—rounds out the pictu

The experience of Voorhees and others like her, at Kell and beyond, is indicative that the EMBA itself is at a cr roads. Created 30 years ago to enhance the management sk of high-potential executives, the EMBA was a credential which companies were more than happy to pay. Manag

The Top 25 EMBA Programs

2005 RANK	SCHOOL	2003 RANK	2001 RANK	GRAD POLL	DIRECTOR POLL	TOTAL TUITION	ENROLLMENT WOMEN	ENROLLMENT MINORITIES	GRA YEA MGM
1	**Northwestern** (Kellogg) Evanston, Ill.	1	1	1	1	$108,000	17%	8%	1
2	**Pennsylvania** (Wharton) Philadelphia	3	3	10	2	128,778	25	5	7
3	**Chicago** Chicago	2	2	3	3	107,000	18	11	9
4	**Michigan** Ann Arbor	NA	NA	2	15	110,000	19	4	11
5	**UNC** (Kenan-Flagler) Chapel Hill, N.C.	5	5	5	8	61,500	14	6	6
6	**Emory** (Goizueta) Atlanta	10	8	7	7	78,000	20	14	8
7	**IMD** Lausanne, Switzerland	6	13	4	10	92,990	16	NA	10
8	**USC** (Marshall) Los Angeles	12	6	6	9	46,000	13	13	11
9	**Duke** (Fuqua-Global) Durham, N.C.	9	NA	8	29	115,700	9	22	14
10	**Georgetown** (McDonough) Washington, D.C.	11	9	9	18	80,700	25	5	7
11	**Duke** (Fuqua-Weekend) Durham, N.C.	4	4	23	4	88,500	14	6	7
12	**Texas** (McCombs) Austin	8	12	12	14	79,400	12	15	6
13	**Ohio State** (Fisher) Columbus	NA	NA	11	32	59,000	24	10	9
14	**UCLA** (Anderson) Los Angeles	7	10	14	13	82,800	19	12	8
15	**IESE** (University of Navarra) Barcelona, Spain	NA	NA	13	24	111,800	20	NA	9
16	**SMU** (Cox) Dallas	18	19	18	12	72,225	23	13	12
17	**Cornell** (Johnson) Ithaca, N.Y.	14	NA	16	16	111,900	13	6	9
18	**Purdue** (Krannert) West Lafayette, Ind.	16	14	17	19	64,000	3	12	9
19	**NYU** (Stern) New York	13	7	36	5	115,000	29	9	7.
20	**Notre Dame** (Mendoza) South Bend, Ind.	NA	NA	21	25	75,500	16	12	9
21	**Queen's** Kingston, Ont.	NA	24	22	27	61,500	14	NA	10
22	**Western Ontario** (Ivey) Mississauga, Ont.	25	15	25	17	62,500	28	NA	9.
23	**Pepperdine** (Graziadio) Culver City, Calif.	19	11	26	26	78,350	37	13	10
24	**Vanderbilt** (Owen) Nashville	20	17	27	30	72,133	28	10	7.
25	**London Business School** London	23	23	35	11	80,750	17	NA	7.

Tuition and enrollment data provided by business schools. Tuition figures for Michigan and Texas are for out-of-state residents. Enrollment figures are for most recent class on main campus. Grads' years of management experien an average based on student survey. Teaching, curriculum, and support grades based on compilation of survey responses. Schools in the top 20% in each category get As, while the next 25% get Bs, the next 35% are awarded Cs, last 20% get Ds. Questions represent only part of the total survey results. More results can be found at www.businessweek.com/bschools.

who signed up for EMBAs would return to their companies upon graduation and apply what they learned immediately. Students received a valuable degree, promotions, and raises. Companies got a significant return on their investment in the form of higher productivity, smarter strategic decision-making, and better managers.

That calculus is changing. EMBA candidates such as Voorhees no longer get the kind of employer support they once enjoyed. These days employers are more likely to be focused on trimming costs. And many students turn down company cash rather than commit to two or more years of continued employment after graduation. In short, the free lunch is disappearing. Only 34% of respondents to a *BusinessWeek* survey of EMBA students this year were entirely company-sponsored—down from 52% in 2001. The number of students who were entirely self-sponsored is now 27%, up from 16% in 2001. Even more telling: Job-hopping EMBA students, once a rarity, now make up a large portion of the typical class. According to the Graduate Management Admission Council (GMAC), provider of the Graduate Management Admission Test, 39% of 2005 EMBA graduates—nearly two out of every five—were looking for new jobs at graduation, up from 17% just three years earlier (charts, page 74).

SCHOOL	GRADED BY GRADS: CURRICULUM	SUPPORT	DESCRIPTION
	A	B	Impressive faculty, high-caliber students, and a helpful staff keep Kellogg at No. 1 for the third straight time.
	B	A	Grads praise rigorous curriculum mirroring traditional MBA. High-quality students and great networking are other pluses.
	C	C	Program dropped a spot due to tough workload and poor staff help. Mixing with colleagues in Barcelona and Singapore wins raves.
	A	A	Grads like relevant, well-rounded education and consultancy project. Fast-paced program not for faint of heart, though.
	A	B	Top-notch faculty and team-based environment wow most grads, but some say classroom facilities need upgrading.
	A	A	High marks for a willingness to make changes based on student feedback. Students complain some areas lack depth.
	B	B	Global focus and diverse student body win raves. But some grads want more high-profile speakers and career services.
	A	A	Grads applaud strong alumni network and praise the program's thematic approach and global perspective.
	C	C	Face-to-face interaction with talented classmates is lacking, but global focus and quality teaching are high on the list of pluses.
	A	C	Grads praise program but complain about poor facilities. New classroom construction is planned.
	D	C	Knowledgeable faculty win high marks, but grads want more real-world coursework and a greater emphasis on soft skills.
	C	A	Responsive staff and challenging coursework win acclaim, but updated curriculum and technology are needed.
	C	A	Solid teaching, excellent support services, and convenient monthly meeting schedule are all pluses.
	C	B	Grads praise the program's strong quantitative analysis component but want more electives and team-based activities.
	B	B	Grads applaud a global EMBA set-up that allows them to study in Barcelona, Madrid, Shanghai, and Silicon Valley.
	A	C	Faculty members who bring real-world experience to the class win raves. But students complain about below-par classmates.
	B	C	Faculty are deemed among the best in the U.S., but that isn't enough. Grads want better support and more guest lectures.
	B	C	Grads praise the international component of program. But they say some professors use outdated materials.
	D	B	Students are 'pampered' by the helpful administrative staff, but want more real-world experience for the high price tag.
	A	A	Grads rave about the program's focus on ethics and quality faculty, but some adjuncts are considered weak.
	B	B	Great networking opportunities and excellent value for the money, but teaching quality is uneven.
	B	C	Grads praise use of case studies but want more stringent entrance requirements to ensure high-caliber student body.
	C	D	Quality of instructors varies greatly and some grads are disappointed by classmates with little experience.
	B	C	Most grads praise faculty, but many classes cover overlapping material. Better coordination is needed.
	B	D	The program's global reach provides "unrivaled international exposure," but students want a commuter-friendly program.

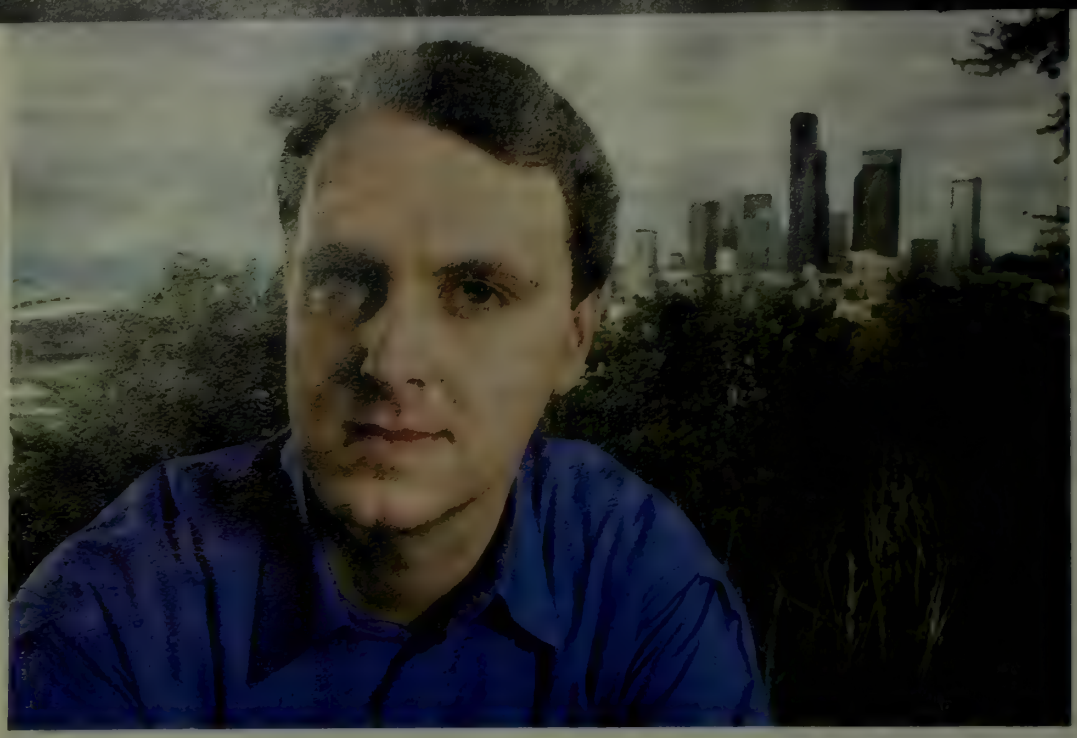
Data: *BusinessWeek*, Cambria Consulting Inc. Research by Louis Lavelle, Geoff Gloeckler, Lindsey Gerdes, Whitney Sparks, Jessica Thacher, and Fred Jespersen

NATIONAL POOL

THE CHANGING demographics of EMBA programs are having a profound effect. Responding to complaints, several schools have begun offering EMBA students a perk that a few years ago would have been unthinkable: career services. In some cases access is restricted to fully self-funded students or company-sponsored students who get permission from their employers. Among the schools opening the doors of career services to EMBA students are Kellogg, Duke University's Fuqua School of Business, and New York University's Stern School of Business. The gradual shift toward "soft skills" such as leadership in recent years may also be the result of the shifting EMBA class profile, since such skills are in high demand among students who intend to hit the job market post-graduation.

With applications to full-time programs in the midst of a three-year slump, many top EMBA programs are looking for growth by marketing themselves to a national applicant pool. That means that ever larger numbers of students aren't local executives but long-haul commuters traveling cross-country to attend class. This year, 20% of students traveled more than 150 miles to attend their EMBA programs, up from 15% in 2001. That has brought with it a host of program changes. Class schedules designed to accommodate long-distance commuters frequently involve longer stretches between classes, making it harder for students to retain material and bond with fellow classmates. At the same time, students have come to expect far more in terms of housing, meals, and logistical support, driving costs up and posing new challenges for staff.

By most measures the past two years have not been terrific ones for EMBA programs. Student satisfaction, as measured by the *BusinessWeek* survey, has not recovered from the beating it took in 2003,



WHARTON GRAD YOUNG: "The No. 1 criterion for me was I didn't want to do an MBA-Lite

when a difficult economy and weak job growth made a high-priced EMBA degree seem like a questionable choice, especially for the growing number of students who were paying their own way. And after a solid year of growth in 2004, applications began to sputter in 2005, with 38% reporting a year-over-year increase, down from 53% the year before, according to GMAC. For many programs that means admission standards must be adjusted—and a larger proportion of applicants accepted—to maintain class size.

Several schools have started offering a perk that would have been unthinkable a few years ago: career services

Tabbush says a rebalancing the curriculum to place gre emphasis on soft skills is alre under way. And at Colun University, students were hi critical of the program's lim course offerings, classes that vided highlights but little or substantive knowledge, poorly prepared classmates. result? The one-time No. 15 gram has fallen out of the ra ings altogether. "There was little I learned from these ple," one grad wrote of his cl mates. "Unfortunately, this business, and Columbia had spots to fill. They were going fill them regardless of the qua of the students." Ethan Hanabury, the new associ dean in charge of Columbia's ecutive MBA program, decli to comment on that char "This definitely presents so challenges for us, but I think program is fundamenta strong," says Hanabury.

If there's any doubt about value of maintaining high st dards, look no further than University of Pennsylvani Wharton School, which mov up a notch, to unseat the Univ sity of Chicago as No. 2. Wharton rallied on the strength of academically rigorous program that prides itself on being "true MBA"—alike in all respects to Wharton's full-time p gram. Eric C. Young, a Wharton graduate and manager of so ware development for Amazon.com Inc., says the Whart EMBA was an academic challenge on par with the school's tw year program. "The No. 1 criterion for me was, I didn't want do an MBA-Lite," Young says. "It was an insane amount work, but that's what I wanted." Equally rigorous academic ly, Chicago nonetheless fell to No. 3 for not sweating the deta according to students, from using old case studies to having i convenient library hou

Rounding out the t five were the University Michigan, a school new considered for ranki this year that catapult into the No. 4 slot, a the University of Nor Carolina at Chapel Hi which held onto its No. ranking. Michigan gra applauded the caliber their classmates and t instructors' ability make the most of st

NEW TO THE LIST

AMID THE TURMOIL, three highly ranked programs fell substantially this year. Students in Duke's weekend program griped about a lack of leadership and ethics training, a focus on theory over practical knowledge, and the school's inability to solve logistical problems such as travel and dining—driving it down seven spots, to No. 11. Duke Dean Douglas T. Breeden says a curriculum review will be completed in three months. The University of California at Los Angeles' Anderson School of Management, which also dropped seven spots, to No. 14, came under fire for a lack of instruction in soft skills, especially leadership and team dynamics. Senior Associate Dean Victor C.

Schools' BEST SUBJECTS

EMBA grads ranked these schools tops in key subject areas

Table includes schools not in the Top 25 but statistically [illegible] rankings

STRATEGY	FINANCE	MARKETING	ETHICS	GLOBAL BUSINESS
Ohio State	Wharton	Michigan	Kellogg	Thunderbird
Emory	Ohio State	William & Mary	Pittsburgh	Emory
Vanderbilt	Chicago	California at Irvine	Notre Dame	USC
UNC	Kellogg	Chicago	Minnesota	Georgetown
Rutgers*	ESADE	Ohio State	ESADE	SMU
U. of Washington*	Rutgers	SMU	IESE	Western Ontario

Data: BusinessWeek, Cambria Consulting Inc.

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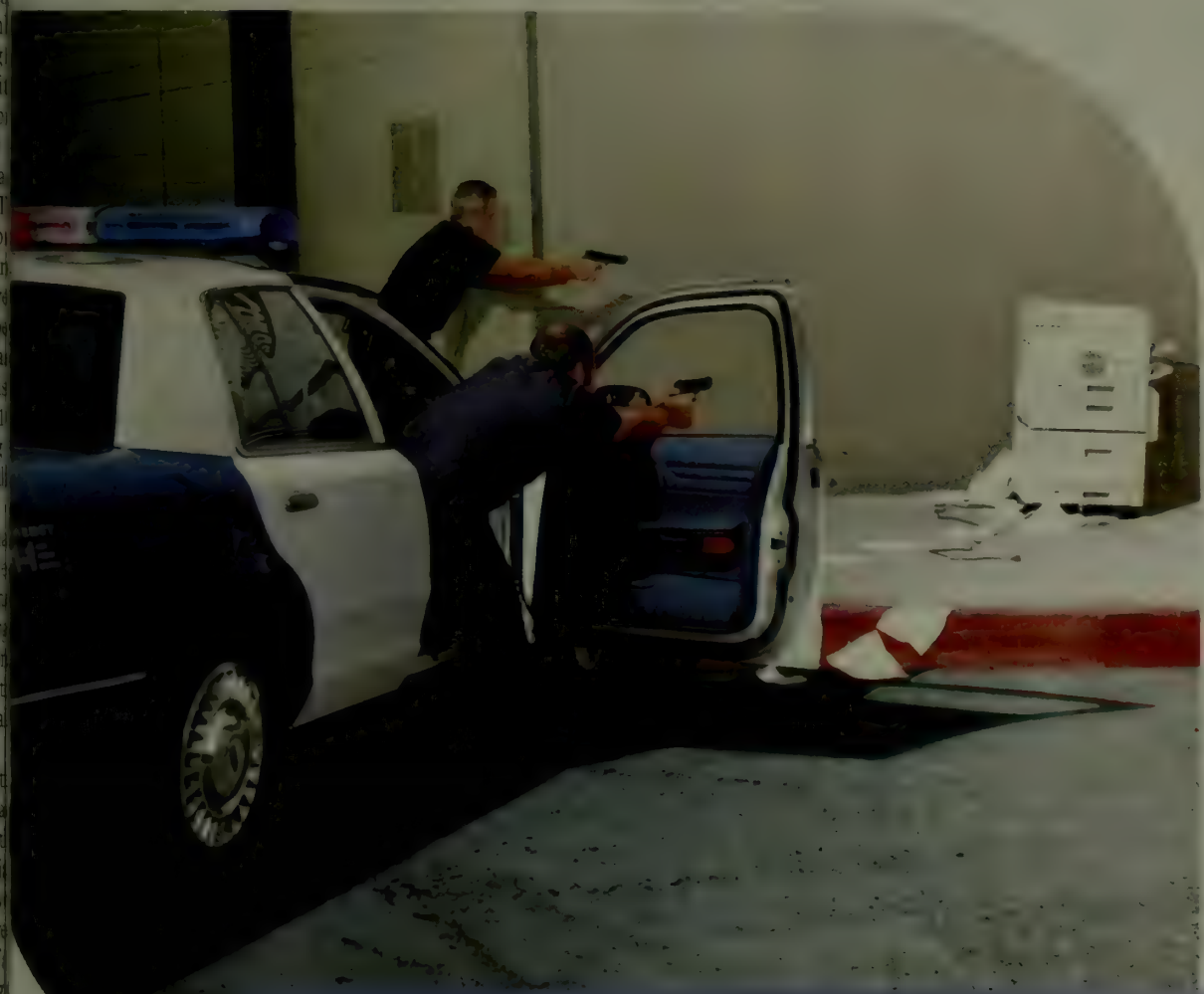

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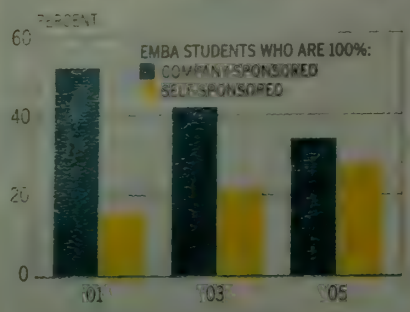
THE CHANGING FACE OF THE EMBA

Once the domain of local mid-career execs seeking a company-sponsored education and a promotion, EMBA programs now have many students paying their own way, traveling great distances, and seeking new jobs after graduation



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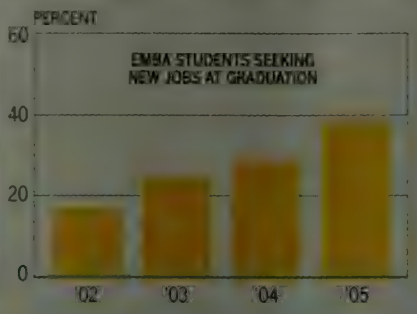
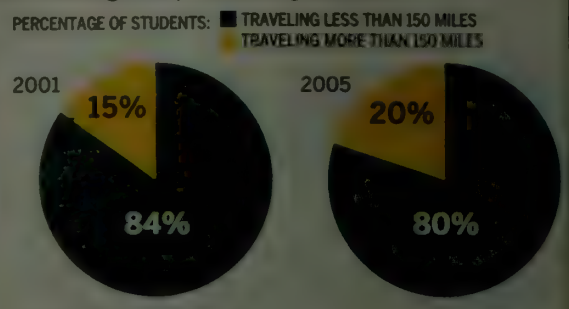


Data: Graduate Management Admission Counsel



Data: *BusinessWeek*, Cambria Consulting Inc.

dents' knowledge—on both measures, Michigan beat No. 1-ranked Kellogg. At UNC, grads gave high marks for teaching quality and responsiveness on logistics. Further down the rankings, at No. 6, Emory University advanced four spots, in large part because of its willingness to address student problems. At one feedback session with Emory's MBA program director, Kembrel Jones, students expressed concern about a professor. Two weeks later the professor was gone, reassigned to the undergrad program.

With tuition climbing and companies getting stingier, expectations are high—one Chicago student even complained about the toaster in the student lounge. Schools that climbed in the rankings are those that met that challenge. Four schools thus entered the rankings for the first time, including Michigan at No. 4, Ohio State at No. 13, Barcelona's IESE at No. 15, and the University of Notre Dame at No. 20. Notre Dame was excluded from the 2003 ranking because no program directors put it on their list of favorites. This year two directors did, and students gave the program kudos for its enthusiastic faculty, high-caliber classmates, and special emphasis on corporate governance, ethics, and leadership.

With the transformation of executive MBA programs still picking up speed, it seems likely that program directors w continue to bear the brunt of change. Being all things to all p ple—a mid-career refresher course for executives on the f track as well as a passport to a new job or career for manag in the slow lane—isn't an easy trick. But more and more th days, meeting that challenge is what distinguishes the b from the rest. ■

–With Geoff Gloeckler and Lindsey Gerdes in New Y

Shop, Compare, and Get Your Career in High Gear

You'll find more than 300 profiles of executive education and executive MBA programs at businessweek.com/bschools. While you're there, check out our story about long-distance EMBA commuters, our video view with Blair Sheppard, the CEO of No. 1-ranked custom executive-education program Duke Corporate Education, plus a new feature called "Behind the Rankings," a special look at shifting student satisfaction with executive MBA programs over the years.

BusinessWeek online

www.businessweek.com/bschools

HOW we did it

As part of our biennial ranking of the best executive MBA programs, *BusinessWeek* relies on two surveys—a poll of recent graduates and a survey of EMBA program directors. The first gives us an on-the-ground look at customer satisfaction, the second provides a sense of each programs' reputation.

This year, *BusinessWeek*, with the help of Boston-based Cambria Consulting Inc., surveyed more than 3,400 members of the 2005 graduating class at 64 programs, garnering a 60% response rate, and 61 EMBA program directors, receiving a 61% response rate. We asked grads about everything from teaching quality to the caliber of their classmates, using their answers to specific questions to award letter grades for teaching, curriculum, and support (table, page 70, 71); to rank the best programs by subject area (table, page 72); and to examine changes in student satisfaction over the years (see "Behind the Rankings," businessweek.com/ bschools).

Combined with student surveys from 2001 and 2003, the student responses contributed 65% of the total score, which determines each program's place in the rankings. The other 35% was supplied by the directors, who were asked to identify 10 programs they consider the best, excluding their own.

In an effort to get a more accurate read on the best programs, this year *BusinessWeek* made two major changes to its methodology. When calculating the student score, we took into account three years of survey data, with the 2005 survey counting for 50% of the score and the 2003 and 2001 surveys counting for 25% each. In 2003, the 2003 survey counted for 66% of the score, while the 2001 survey counted for 33%. The second change involved the calculation of the total score. Instead of equally weighting the student and director surveys, as we did in 2003, this year we overweighted the student survey, as noted above. Our goal was to assign the most weight to the individuals with the most direct knowledge of the programs they're judging, and the changes do that. Combined, the two changes give students—particularly the most recent class—more influence over the final ranking.

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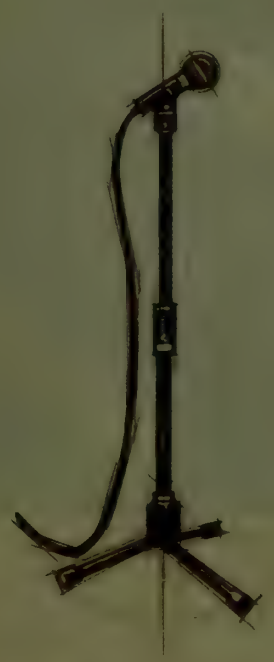

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HEAD

Executive educat

ON THE COURT
PricewaterhouseCoopers students working with Duke's Mike Jarvis II

RICHARD FREEDA/AURORA

BY GEOFF GLOECKLER

OF THE CLASS

rams that deliver real-world examples get the highest ratings

THE BUZZER SOUNDS, and five players take the court, each in a blue practice jersey emblazoned with one of the most recognizable names in college basketball: Duke. The coach goes over a play, then has his team members try it out. It doesn't go well. A pass hits a knee and rolls out of bounds; two players crash into each other; another falls face first to the floor. Not what you would expect from the Blue Devils. But that's because these aren't real college players. They're desk jockeys from accounting giant PricewaterhouseCoopers, taking part in a weeklong program on finding work/life balance, hosted by Duke Corporate Education (CE). And the hoops drill at Monmouth University in West Long Branch, N.J., is aimed at improving goal-setting skills.

While the players are fakes, the coach, in fact, is real: head manager for Duke University's men's basketball team, Mike Jarvis II. He has the team try the play again. And again. And again. Finally, it clicks. The pass finds its intended receiver, teammates complete a perfect *pas de deux*, and a jump shot from 12 feet out hits nothing but net—no clumsy maneuvers, no fouls, no face plants. "For that moment, you were Duke basketball," Jarvis exults. These businesspeople will never realize any hoop dreams, but in the span of a few hours they have gone from a ragtag bunch of wannabes to a real team. In doing so, they managed to learn what it takes to set and achieve goals—in basketball or business—in a way that could never be conveyed by a lecture or a PowerPoint presentation.

This kind of class outing is a hallmark of Duke CE, a for-profit carve-out of the Duke University Executive Education practice. It's also a big part of the reason Duke has landed at the top of *BusinessWeek*'s 2005 rankings of Custom Executive Education providers for the second time. With abundant financial and

human resources to lavish on its programs, Duke CE has succeeded in molding its game into one that's tough for most competitors to match.

But Duke's success hasn't happened in a vacuum. In fact, for the first time since the dot-com bust, executive education is experiencing something of a boom, with both custom and open-enrollment programs registering double-digit growth. At the same time, the healthier climate has sparked more competition, and the industry is starting to see the beginnings of a shakeout. Even top-ranked programs like Duke's are starting to feel the pressure. "Anyone who thinks they are ahead had better not believe it," says Blair Sheppard, president and CEO of Duke CE. "Or you're going to fall out of the race."

The winners this year were the programs skilled at transforming midlevel managers into instruments of change. deed, exec-ed programs now occupy a strategic role they n had before, says Stephen LaCivita, associate dean of execu education at the University of Chicago and former chair of International University Consortium of Executive Educat "More top execs are driving systemwide change in their c panies by using exec ed," says LaCivita. "That is exactly why custom programs have been rising like they have."

This year marks the second time *BusinessWeek* ranks tomized and open-enrollment programs separately, as the p pose of each grows more distinct. Open-enrollment progra which typically last a few days, are one-size-fits-all classes s able for a variety of companies, in such subjects as strat marketing, or financial management. Custom programs

The 20 BEST EXECUTIVE EDUCATION Programs

OPEN ENROLLMENT

RANK	PROVIDER/ LOCATION	2003 RANK	2004-05 TOTAL REVENUE* (MILLIONS)	OPEN PROGRAMS OFFERED	FIVE-YEAR REVENUE CHANGE	HOW THEY SCORED ON: GLOBAL BUSINESS	INNOVATION	LEADERSHIP	ST PR
1	**Harvard** Boston	1	76	66	NA	A	A	A	
2	**INSEAD** France/Singapore	5	$85.1	136	104.6%	A	A	A	
3	**IMD** Lausanne, Switzerland	8	62	137	28.3	A	A	A	
4	**Stanford** Stanford, Calif.	6	21.2	40	43.2	B	C	A	
5	**London Business School** London	10	43.9	27	55.1	A	B	A	
6	**Michigan** Ann Arbor, Mich.	3	17.2	77	-35.1	B	A	A	
7	**Columbia** New York	7	16	62	4.6	B	C	B	
8	**Pennsylvania (Wharton)** Philadelphia	2	NA	53	NA	B	B	B	
9	**Northwestern (Kellogg)** Evanston, Ill.	9	NA	83	NA	D	B	C	
10	**Queen's University** Kingston, Ont.	NR	NA	11	34	A	A	A	
11	**IESE** Barcelona	18	40.1	142	NA	A	A	A	
12	**Virginia (Darden)** Charlottesville, Va.	11	17.2	68	-13.1	B	B	A	
13	**Duke (Fuqua)** Durham, N.C.	17	NA	10	NA	B	C	C	
14	**Western Ontario (Ivey)** London, Ont.	NR	NA	7	NA	D	C	A	
15	**MIT (Sloan)** Cambridge, Mass.	16	17	39	70	C	A	C	
16	**Thunderbird** Glendale, Ariz.	13	15.5	179	32.5	A	C	B	
17	**York (Schulich)** Toronto	NR	14.3	243	NA	C	B	C	
18	**Chicago** Chicago	12	12	32	71.4	C	D	D	
19	**UNC (Kenan-Flagler)** Chapel Hill, N.C.	20	10.4	43	38.7	C	C	B	
20	**Toronto (Rotman)** Toronto	NR	7.7	40	79.1	B	B	B	

Rankings were determined by the results of an online survey *BusinessWeek* sent to 539 companies. 163 responded (30%). Companies indicated familiarity with both university and private-sector providers and ranked them in order of b overall for both custom and open enrollment programs. A No 1 ranking was assigned 10 points. No 2 nine points, etc. To compute the ranking, the total score for a school/provider was multiplied by the number of companies ranking the number of companies that indicated familiarity. Letter grades are based on the average of all responses in each of the categories, which represent only a portion of the total survey. The top 20% earning an A. The next 25% receiv 35% were awarded Cs, and the bottom 20% got Ds. Schools with too few responses received an NA. Schools/providers ranked too infrequently were disqualified. The survey was administered and rankings were tabulated by Cambri

ents tailored assistance in solving specific, pressing prob-ns—anything from succession planning to global expansion. To come up with the rankings, *BusinessWeek* surveyed man-ers and human resources directors from 163 companies in 22 ntries about open and customized executive education pro-ms (table). All told, the companies sent more than 21,000 ployees to courses and spent hundreds of millions of dollars B-schools and non-university-affiliated organizations. Of the programs mentioned in the rankings, 10 are based outside of U.S., up from five in 2003, a trend that reflects companies' sire for a better understanding of global markets.

In the relatively stable world of the MBA rankings, such atility is virtually unknown. But executive education is con-ntly in motion, with new programs popping up and others gaining strength. Case in point: Seven new players entered the rankings this year for the first time—among them Queen's University in Kingston, Ont., the No. 10-ranked open program, and Penn State, No. 8 among custom programs. These displaced familiar names like New York University and the Center for Creative Leadership in Greensboro, N.C., which dropped from the rankings even though it got top marks in leadership training.

CUSTOMIZED CURRICULUM

PROVIDER/ LOCATION	2003 RANK PROGRAMS	% REVENUE FROM CUSTOM	REVENUE MILLIONS 2004-05	NO. CLIENTS SERVED
Duke Corporate Education** Durham, N.C.	1	100%	$42	54
IMD Lausanne, Switzerland	3	51	31.8	82
INSEAD France/Singapore	5	52	44.1	90
Virginia (Darden) Charlottesville, Va.	6	57	11.4	28
Michigan Ann Arbor, Mich.	9	28	4.8	14
London Business School London	14	52	22.9	52
Harvard Boston	2	NA	NA	20
Penn State (Smeal) University Park, Pa.	NR	70	3	19
Stanford Stanford, Calif.	13	NA	NA	10
Northwestern (Kellogg) Evanston, Ill.	8	41	NA	24
Pennsylvania (Wharton) Philadelphia	4	NA	NA	NA
IESE Barcelona	NR	30	9.7	76
Toronto (Rotman) Toronto	18	55	4.3	18
York (Schulich) Toronto	NR	40	5.7	71
Thunderbird Glendale, Ariz.	12	69	12.3	131
ESADE Barcelona	NR	45	NA	64
UNC (Kenan-Flagler) Chapel Hill, N.C.	NR	79	8.8	35
Babson College Babson Park, Mass.	10	80	11.2	60
Instituto de Empresa Madrid	NR	NA	NA	73
Columbia New York	11	34	5.5	17

all custom and open enrollment revenues
niversity's custom education programs are run through Duke Corporate Education, a for-profit company
nbria Consulting Inc., *BusinessWeek*; Research by Geoff Gloeckler,
elle, Lindsey Gerdes, Whitney Sparks, Jessica Thacher, and Jeffrey Gangemi

COUNTING THE COST

MUCH OF THE MOVEMENT this year can be attributed to a new cost-consciousness. While many larger companies have increased training budgets, managers at some small-to-midsize businesses have questioned the return on programs that can easily cost upwards of $10,000 per person and have directed their spending accordingly. For them, the best return came from programs taught by someone with business experience, rather than academics who may be years removed from the corporate world. One of the programs doing a good job of combining business and academia is Stanford University, ranked No. 4 for open enrollment and No. 9 in custom programs. In its 10-day Strategy Marketing Management offering, for instance, participants are taught by a group of top Stanford marketing faculty with industry experts and executives from companies such as Intel Corp.

Failure to deliver that kind of firsthand experience has consequences. Some programs—including Case Western Reserve University—fell off the list this year for just that reason. "It's time for schools to get out of the 'school' mentality and into the 'business' mentality," says Dennis Baltzey, head of leadership development for Royal Dutch/Shell Group, which sends students to IMD International, Duke CE, and INSEAD. "Schools that are doing it right work to understand your business. They have taken a page from the consulting field."

Harvard has written that book. The No. 1 open-enrollment provider plays to its strengths, using its case study method in both open classes and custom programs like those developed for outfits as diverse as the NAACP and the NFL. That strategy provides companies with the kind of instruction they want—steeped in real-world experience—and supplies Harvard with new clients that serve as grist for its case-writing mill. "Executives coming here want to hear from a faculty that has a lot of contact with practice," says Srikant M. Datar, senior associate dean and head of executive programs. "Because of our focus on field-based research, we can provide this."

Behind Harvard in open enrollment is INSEAD, in Fontainebleau, France. Since the program's inception in 1968, INSEAD's focus has been global, and the

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ool has benefited strongly from globalization. In 1998, en other programs were forming joint ventures with Asian chools, INSEAD chose to go it alone and open a satellite npus in Singapore. Today, 30% of INSEAD'S exec-ed pro-mming takes place there, supported by 40 full-time facul-More than 50% of those clients come from outside of Asia, n more and more from the U.S. They're looking for a ader focus that many U.S. B-schools lack, says Soumitra ta, dean of executive education. Companies recognized this as a strength at INSEAD, giving it high marks not only in global business but also in innovation.

For institutions like INSEAD, 2005 was an exciting year. Growing complexity in business made the hands-on training at such programs more critical for companies and more lucrative for providers. But the providers also learned an important lesson: If they want to remain on top, they need to supply training rooted in real-world practice. Esoteric theory may have a place in B-schools, but the executive-education classroom isn't it.

Programs PICKING UP THE PACE

First came the full-time, two-year MBA program. As its popularity grew, a weekend "executive" variation was developed for promotion-hungry managers whose companies often sponsored hem. Then followed part-time degrees for tudents whose busy schedules could ccommodate only limited classroom ours. Now comes the latest innovation, he drive-through MBA—miniaturized rograms that let students earn degrees in alf the time.

The trend started in Europe, where top usiness schools like INSEAD began offering ntensive, full-time programs in as little as 10 months. Now some European schools are lso offering a one-year "pre-experience" nasters in management for recent ndergrads. The trend is coming to the U.S., here schools scramble to attract fence-itting candidates who hesitate to take two ears off from work but are also wary of pending half a decade pursuing a degree art-time.

Schools such as Georgia State University nd Babson College have developed "fast-rack" part-time programs and professional BAs that allow students to keep their aychecks while getting their egree in two years. Typically, uch programs involve weekend nd evening courses, as well as distance-learning component n the Internet, to wrap classes p in the allotted time.

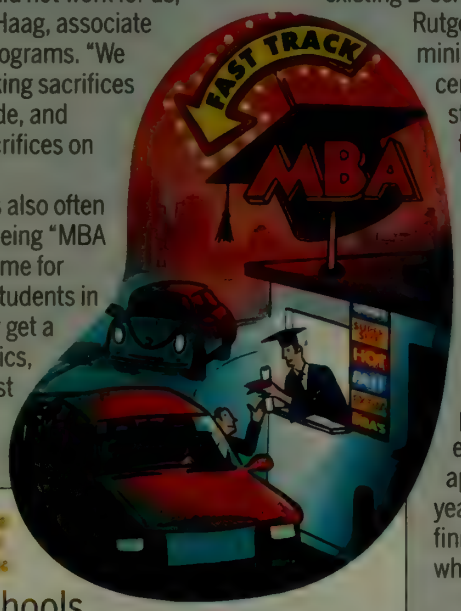
There are also "accelerated" ull-time programs, such as the ne offered by Drexel University n Philadelphia, that confer an BA in as little as a year, and ven mini-MBAs that award ertificates but no degree. "It lays to the pace of the world e're in today," says Brad Bays, BA programs director at Ohio's iami University. His school crapped its two-year MBA last year and replaced it with an intensive program completed in 14 straight months.

But are the drive-through MBAs the real deal? Skeptics dislike the intensity of the fast-paced programs, which may not be suitable for younger students who need more time than seasoned execs to absorb difficult concepts. And the rigid structure often required of these abbreviated degrees leaves little room for electives.

The University of Denver's Daniels College of Business shuttered its accelerated full-time program in 2003 but kept its traditional two-year program for just that reason. "It just did not work for us," complains Stephen Haag, associate dean for graduate programs. "We found ourselves making sacrifices on the curriculum side, and students making sacrifices on the learning side."

Shorter programs also often carry the stigma of being "MBA Lites." With limited time for advanced courses, students in some programs may get a grounding in the basics, but that's it. And most accelerated programs lack a summer internship component, an important tool companies use to scout potential hires. "Generally, recruiters don't like them," says Maury Hanigan, an MBA recruitment consultant.

The new accelerated programs are different from previous niche products such as the executive and part-time MBA and executive ed courses, which have become popular enough to eat into full-time enrollment. If anything, the new programs are designed to appeal to a new demographic—people unwilling to make the investment in time and money required by existing B-school alternatives.



Rutgers University now offers a mini-MBA, a 12-week certificate program in which students earn three credits toward a full-blown Rutgers masters for $2,495—a fraction of what a typical two-year program costs. Abe Weiss, director of Rutgers' Center for Management Development, says such programs may even encourage students to apply to a traditional two-year program when they're finished: "We're trying to whet people's appetites."

The proliferation of choices facing prospective business students these days is already daunting, and with the advent of drive-through MBAs it will become even more so. But to lure its share of applicants in a fragmented marketplace, a B-school today must offer a complete suite of programs—including those that offer instant gratification.

–By Lindsey Gerdes in New York

MBA LITE

For busy execs, B-schools now offer alternatives to a two-year degree

THE ACCELERATOR Accelerated programs reduce the time it takes to get an MBA to as little as 10 months.

FOR THE PROS "Professional" MBAs for those with three years of work experience only require two years of weekends or evenings.

THE ONE-YEAR PLAN Some European schools offer a "pre-experience" masters in management to give students a taste of business.

CERTIFIABLE The fastest of all the "MBA Lites," some certificate programs give a smattering of biz education in just weeks.

NO VELVEETA Many nation brands are notably absent

Eating Too Fast at Whole Foods

The high-end grocer has the Big Mo, but its growth strategy may prove perishable

COUNTERS GROAN WITH creamy hunks of artisanal cheese. Medjool dates beckon amid rows of exotic fruit. Savory breads rest near fruit-drenched pastries, and prepared dishes like sesame-encrusted tuna rival what's sold in fine restaurants. Staff people smile, happy to suggest wines that go with a particular cheese, or pause to debate the virtues of peanut butter maltballs. And it's all done against a backdrop of eye-pleasing earth-toned hues and soft lighting.

This is grocery shopping? Well, not as most people know it. Austin (Tex.)-based Whole Foods Market Inc. has cultivated its mystique with shoppers—and investors—by being anything but a regular supermarket chain. It proudly offers premium products at premium prices, and its stock trades at a multiple that can be almost triple other food retailers. At $128, it's about 42 times next year's projected earnings per share, according to Adams Harkness Inc. equity analyst Scott Van Winkle. Among the reasons: 15% same-store sales growth in an indu where the norm is closer to zero, an tious expansion plans, and the gen sense that Whole Foods is, well, spec "I keep waiting for the competition been hearing about," says Chief Exe tive John Mackey, "but nobody else is ing quite what we're doing."

He's right, in large part. While cha from Trader Joe's to Wegmans Fo Markets Inc. are catering to the grow interest in organic and gourmet foo no one has yet to match the ambie and selection of Whole Foods. Since launch in 1980, the 176-store chain nurtured a robust culture and cu like following.

But the $3.9 billion company is a critical inflection point. Not every hot tail startup is able to sustain the ma Will Whole Foods take o the world like Starbucks? will it overexpand and c off like, say, The Bo Shop? With 65 stores in velopment—most of wh are significantly bigger th the older locations—Mac has to cope with challen from a fragmented sup chain to new stock regu tions that make it tougher shower the once-ubiquit

Esoteric offerings and lofty prices could limit wide appeal

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stock options on employees without hurting the bottom line. Some also suspect that the brand's cachet could start to diminish as stores become more ubiquitous and copycat competitors sprout up. Despite hawking itself as "the world's leading retailer of natural and organic foods," its prepared food and many other products aren't organic. And don't even think of going there for a bag of Doritos chips.

While many analysts think the country could sustain up to 500 stores, even Mackey isn't sure at what point Whole Foods' high-end model will start to tap out. "I used to think 100 stores would saturate the market," he says. Then there is the issue of the stock price. Even if the company is "hitting on all cylinders," as Bear, Stearns & Co. analyst Robert Summers says Whole Foods is, the stock's giddy levels make him predict that it will underperform the broad market. After releasing its third-quarter earnings in July, Whole Foods actually sported a higher multiple than Google.

A BREED APART

NONE OF THOSE CONCERNS deter the faithful. Consider New York opera singer Bert Boone, who gushes, "I'm addicted to the onion focaccia bread!" But Boone also exposes another potential weakness in the Whole Foods formula. For all of his enthusiasm, onion focaccia and a "few other special things" are about all he is willing to buy. In California, the chain is frequently dubbed "Whole Paycheck."

Mackey dismisses the notion that customers may start to blanch at Whole Foods' prices, especially as other options spring up, arguing that "we're selling the highest-quality food in the world." But the perception that Whole Foods is a shrine to exquisite, costly products has not diminished as the chain expands. And it's selling that food in increasingly larger stores: new locations average more than 53,000 square feet, which is about two-thirds larger than the average size of existing stores. That's a lot of space to devote to fresh sushi and earth-friendly toilet paper, especially when Whole Foods' obsession with differentiating itself from the supermarket pack means that it shuns most major brands. Larger stores will inevitably require more products, more employees, and more volume. Suddenly, Whole Foods may seem a whole lot less special. The company says bigger stores allow more room for higher-margin prepared foods.

Another problem: "They don't have a professional supply chain," says one consultant

As Whole Foods gets scale, its ability to efficiently manage distribution becomes a greater issue, too. It has 11 geographic divisions, each boasting its own president and handling its own store network. That's fine for a regional player, but a company that aspires to have $10 billion in annual sales within the next few years requires a more centralized strategy. Right now, everything from transportation to product sourcing is local. "They don't have a professi supply chain," says one consultant miliar with the company. Whole Foo working on these logistical issues, faces less pressure to be efficient bec of premium prices. Mackey stresses the store is not supply chain-dri "Wal-Mart so much dominates mind-set in retail," he says. "Not ev one is concerned with getting medi food at the lowest price."

UNIQUE CULTURE

INDEED, TRADITIONAL superman such as Wegmans and Roche Brot have adapted to the growing interes natural and organic foods and are tryin make their interiors more inviting. Fa ers' markets and smaller specialty ou are also growing. Supermarketguru. editor Phil Lempert points out tha far as prepared foods is concer Whole Foods' image is better than r ty—possibly exposing the company customer backlash. "If you're goin brand yourself as the country's first ganic supermarket, you've got to be letproof," says Lempert.

A much more difficult task for a gr ing Whole Foods will be maintainin unique culture which, among o things, caps the salaries of top exec 14 times the average pay. Shateema lard typifies the loyalty of many worl After two years, the Manhattan emp ee is a supervisor and boasts of her stock option grants. Never mind that investment may be worth less than $ and she's not unionized. Dillard well-paid and confident that "opport ties for growth are phenomenal."

Clearly, Whole Foods is thrivin what remains a low-margin and tig squeezed industry. It is more profit than peers, with gross margins of over the past year, vs. 24% for Kr Co. and 29% for Safeway Inc., accor to market research firm Capital IQ (*BusinessWeek*, a unit of The McGraw Companies). But Whole Foods' va tion could prove perishable. While tomers will no doubt continue to cla for *prosciutto di Parma* and roa heirloom tomatoes, they may be ha to buy such items elsewhere, too come here for Tazo chai (concentr and the fantastic cheese," says Yorker Jennifer Lee. But if her market would keep those on the shel she says she could live without the at Whole Foods. ■

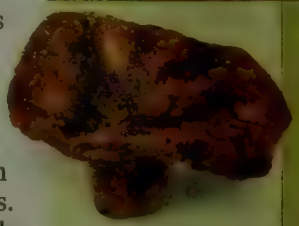
–By Diane Brady in New Y with Adrienne Carter in Chicago Sarah Lacy in San Mateo, C

"Whole Paycheck"

A visit to the 59,000-square-foot Whole Foods Market at New York's Columbus Circle makes it abundantly clear: This is not your mother's supermarket.

Organic Jasmine Pearl Green Tea (3 oz.) **$14**

Grafitti Eggplants Holland grown **$4/lb.**



Lobster Mushroom from Oregon **$25/lb.**

Herban Essentials Pet Toilettes (20) **$14**

Data: BusinessWeek, prices rounded up

PROFESSION: PILOT
CAREER: ACTOR

otographed by Patricia von Ah on the private runway of
Travolta residence in Ocala, Florida.

I LIKE TO FLY AT LEAST ONCE A DAY."

ople are acquainted with the star, the multi-faceted actor. But John avolta is also a seasoned pilot with more than 5,000 flight hours der his belt, and is certified on eight different aircraft, including the eing 747-400 Jumbo Jet. As a young boy in New Jersey, he already ed to dream of flying as he watched planes criss-crossing the sky ound the New York airports. Today, John Travolta travels the world at e controls of his own airliner and nurtures a passion for everything t embodies the authentic spirit of aviation. Like BREITLING wrist truments. Founded in 1884, BREITLING has shared all the finest hours aeronautical history. Models such as the NAVITIMER have become cult ects for pilots the world over. Where safety is of crucial importance, EITLING is known as the specialist in reliable and high-performance rist instruments" designed and tested for the most demanding ofessionals. BREITLING chronographs meet the highest standards of rdiness and functionality, and are equipped with movements that are ronometer-certified by the COSC (Swiss Official Chronometer sting Institute) – the highest reference in terms of precision and ability. One simply does not become an aviation supplier by chance.

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INSTRUMENTS FOR PROFESSIONALS™

ON YOUR MARK... Apache says it gets wells up and running twice as fast as its rivals

The Fastest Drill In the West

Quick decisions and risk-taking have led to an earnings gusher at Apache

IT HAS BEEN A GOOD YEAR FOR most companies that pull oil out of the ground, with crude at $60-plus a barrel. But it has been an especially rewarding time for Apache Corp., which is reaping the benefits of one of the most aggressive strategies in the industry. The Houston company is expected to earn $2.7 billion this year on revenues of $7.4 billion, more than tripling its earnings since 2000. Its net margin, 31.5%, is one of the highest among its exploration-company peers. Numbers like that landed it the No. 10 spot on the *BusinessWeek* 50 list of top corporate performers.

Apache is emblematic of the so-called independent oil companies. Larger, more cautious majors, such as Exxon Mobil Corp., look for huge fields that can take a long time to develop but will then go on to produce steady returns for years. By contrast, independents often drill smaller prospects in mature fields that produce the fastest possible payback. "Exxon is interested in assets that last a decade-plus," says Paul Ziff, founder of Calgary consultant Ziff Energy Group Ltd. "Apache is interested in real-time returns."

THE BUSINESSWEEK 50 The Best Performers

As a result, the Apaches of the world are playing a crucial role in global energy markets by quickly ramping up drilling budgets to boost output. According to energy research firm John S. Herold Inc., independent oil companies boosted their worldwide oil-and-gas production by 38% over the past five years, to 2.6 million barrels a day. The majors increased th output at less than half that rate, to 1 million barrels.

SHARING THE WEALTH

APACHE HAS BEEN able to outperfor its peers by creating a culture that valu quick decision-making and risk-taking starts with new hires: The compa looks for people who have shown init tive in getting projects done at oth companies. And its employees are amp rewarded. Field managers can ea bonuses equal to 50% of their ann salaries by meeting yearly profit and pr duction goals. And every worker, from t mailroom up, shares in a sto award program pegged to a gressive share price targets. Sa CEO G. Steven Farris: "Ever body's a part of the action."

For years, Apache followed "acquire and exploit" strateg buying older fields from larg companies and drilling the heck out them. By mid-2004, though, Farris deci ed that the acquisition market had gott too pricey. So that year he orchestrated novel deal with ExxonMobil. Apac traded access to some deep, hard-to-dr prospects in Louisiana for the right drill on 1.2 million acres of shallow ExxonMobil property in central Canad The transaction lets Apache focus only the prospects it finds the most attractiv And rather than acquire the Canadi property outright, which would have co

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hundreds of millions of dollars, Apache is giving ExxonMobil a royalty of 37%.

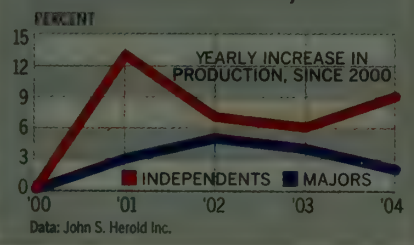
Once the pact was signed, Apache's unique approach to drilling let it hit the ground running. Many energy producers focus on the largest fields first. Once they strike oil or gas, they start building the pipelines and compressor stations to bring it to market. Not Apache. It takes the opposite approach—looking for the nearest infrastructure, then drilling the prospects closest to it.

Apache has also devised a variety of strategies to speed oil recovery. Often it will start drilling before it has finished the seismic work on a particular field—as many as four wells at a time. It also uses flexible drilling pipe rather than the rigid sections of pipe many operators still use. Not having to stop to attach the pipe sections makes Apache's drilling process more continuous. Brian Schmidt, president of Apache's Canadian operations, says his average well takes 61 days to bring online—twice as fast as others on similar terrain. Schmidt originally planned to drill 125 wells on the Exxon land in the first year of the deal. Instead, Apache drilled 260.

The company has hustled right from the start. Raymond Plank, who founded Apache in 1954 with two partners, vowed to produce profits that first year. He did, earning $12,500 on revenues of $190,000. Plank, who at 83 is still

INDEPENDENTS' DAY

Independent oil producers such as Apache Corp. have upped production far faster than the oil majors



Data: John S. Herold Inc.

chairman, and Farris have learned to react quickly to changing times. They hiked Apache's drilling budget from $890 million in 2002 to $3.4 billion this year to take advantage of rising prices.

Of course, drilling like crazy has its risks. "One of the problems with prices where they are today," Farris observes, "is the tendency to do things you might otherwise not do because you have a lot of cash." No doubt—but it's a problem most companies would love to have. ■

–By Christopher Palmeri in Los Angeles

(TOP TO BOTTOM) BILL FRAKES/SPORTS ILLUSTRATED; CHRIS DORST/AP/WIDE WORLD

Bad-Luck Jockeys

A $20 billion business is being roiled by riders with shaky health insurance

FOR YEARS, JOCKEY GARY Birzer spent more time trying to snare mounts and win races than worrying about his future. But when he got engaged in 1998, he realized he had better look out for his family, since jockeys have a 60% chance of being injured in any given year. So he joined the Jockeys' Guild, an organization founded in 1940 primarily to take care of the health of jockeys. It provided insurance coverage—up to $1 million for medical costs in the event of an on-track accident. If the worst happened, Birzer figured, he and his wife, Amy, wouldn't have to worry about medical bills.

He was wrong. On July 20, 2004, Birzer's horse fell at West Virginia's Mountaineer Race Track. The jockey's back was broken, paralyzing him from the waist down. Then Birzer learned the rest of the bad news: The guild had quietly canceled its $1 million catastrophic policy more than two years earlier. "The fact is that they let it lapse, and the fact is that they failed to notify any of the riders," says jockey Eddie King Jr.

By the time he got the news, Birzer was in a spinal cord injury hospital, and the bills were mounting—far beyond the $100,000 covered by Mountaineer's own policy. Guild officials assured Amy that they would still cover the expens but no bills were paid. In November 1 hospital finally told the Birzers that G would have to transfer to another hos tal if they didn't pay. When the guild s it couldn't help, Amy broke down tears, according to the Birzers' lawy Paul S. Koczkur.

Now the couple's debt is close $800,000. They can afford only mi mal rehabilitation services. And Gar story—along with a slew of questio about the guild and its current management team—is shaking up the often insular world of horse

BIRZER Paral from the wai down, with $800,000 in

ng. "What happened to Gary is un-
scionable," says Richard B. Shapiro,
missioner of the California Horse
ing Board (CHRB), an agency that
held contributions to the guild in
wake of Birzer's accident.

The fallout has been far-reaching. "It
changed the landscape of the indus-
says Steve Sexton, president of
rchill Downs Inc. Last November, 15
keys refused to race at Churchill Downs
Louisville, Ky., without additional on-
k health coverage, leading to rifts
ng jockeys and between tracks and
rs. Lawsuits are flying amid allegations
uild mismanagement. And on Oct. 18
House Energy & Commerce subcom-
ee on oversight and investigations
s to hold hearings with the Birzers,
r jockeys, and guild leaders. "We want
determine why an industry with so
h money got in a position where jock-
exercise riders, and back-stretch

workers who suffer injuries do not have adequate coverage," explains subcommittee Chairman Ed Whitfield (R-Ky.). He says he decided to investigate after reading articles in *SportsBusiness Journal* and in horse trade publications.

Birzer declined to talk before the hearing. But guild President L. Wayne Gertmenian and General Counsel Lloyd Ownbey Jr. aren't so reticent. In response to charges of mismanagement, of not taking care of its members, and of failing to account for guild money, Ownbey blames track owners, whom he accuses of trying to bust the guild. "Those guys never got out of the Neanderthal early 20th century [in labor relations]," he says. Ownbey also insists that Congress is in cahoots with millionaire owners, and in an Aug. 31 letter he attacked Whitfield's chief investigator as "an unfriendly, rude, humorless bully." Says Ownbey: "I was a little colorful in that letter."

It has never been easy for jockeys, who are classified as independent contractors, to make a unified push for workplace benefits. "We are so competitive against each other. It's hard to shut that off," explains jockey Robert Colton.

The Jockeys' Guild used to function as neutral territory, while providing off- and on-track health insurance to its members. By 2000, though, strains were showing. After some serious accidents, premiums on the health plan jumped 43%. "Insurance companies don't want to cover jockeys, viewing them as accidents waiting to happen, which is true," says John Giovanni, guild manager from 1987 to 2001 and a former jockey. Unable to afford the premium hike, he made arrangements to put members on COBRA. "I figured that would give me 18 months to renegotiate another plan," he says. At the same time, in April, 2001, he bought a $1 million catastrophic health policy for $443,000 to cover members injured on the racetrack.

This didn't win him much support. however. Arguing that Giovanni was falling short in medical coverage, pensions, and other issues, a group of jockeys led by Chris McCarron sparked a revolt. They succeeded in getting Giovanni replaced by Gertmenian, a charismatic professor at Pepperdine University with no horse-racing experience, whom McCarron had met through his daughter.

"RISKING LIFE AND LIMB"

McCARRON LATER became disenchanted with Gertmenian and left the board. Other jockeys, like Eddie King, who became guild treasurer, were ousted when they began to ask questions about the new management's financial dealings. But the crucial moment came in April, 2002. That's when Gertmenian let the catastrophic $1 million health policy lapse. "No jockeys were notified," says Gary Donahue, who had been running the Disabled Jockeys' Fund for the guild. "They were riding and risking life and limb, and they didn't know they did not have a policy. It was ludicrous."

Ownbey claims that a December, 2001, document, which mentions that the guild can't afford the policy, is evidence that jockeys were informed. Gertmenian, who still has supporters among jockeys, admits there was no formal notification but argues that the policy didn't adequately protect jockeys anyway. Others disagree. "I believe the jockeys are victims of the current management of the guild," says the CHRB's Shapiro.

The hope of Gary Birzer and other jockeys is that the congressional hearings will put a national spotlight on the plight of jockeys, exercise riders, and others in the industry who don't have normal worker protections. "The only salvation the jockeys have is what happens at the hearing," says former guild head Giovanni.

In the meantime, the Jockeys' Guild hasn't totally forgotten Gary Birzer, says Koczkur: "They rented an apartment for him for 12 months and gave him $15,000 for a [disabled access] van." Argues Gertmenian: "I'm sure we've helped Gary with everything we possibly can." But the apartment rent is about to run out, and the Birzers are falling back on donations from the horse-racing community. "Amy and Gary have a lot of good feelings towards other jockeys and the racing community," Koczkur says. "But they are very disheartened by what they feel as abandonment by the guild." Investigations, hearings, and lawsuits aren't going to make that feeling go away. ■

–By John Carey in Washington

No **Canter** In the Park

he $20 billion horse-
cing industry is
pendent on jockeys,
ercise riders, and stable
nds. While a few of the
ndreds of riders are rich
d famous, most scrape
get by. Here are some
sues they face:

- Earnings average under $35,000 per year
- Conditions are often hazardous—from exercising in the dark to racing in storms
- Only five states have workers' compensation
- There are no uniform safety standards for tracks
- Jockeys average a 60% chance of injury each year
- Classified as independent contractors, they can't bring grievances to the National Labor Relations Board
- At many race tracks, injury-related medical costs are covered only up to $100,000

YAGAN
The 28-year-old is already a serial entrepreneur

A Hard Ride For eDonkey

The file-sharing service has been forced to reinvent itself by a Supreme Court ruling

ON THE MORNING OF June 27, Sam Yagan huddled with his partner, Jed McCaleb, before one of the five computer screens in their dingy, one-room office in Hoboken, N.J. Yagan, chief executive of startup MetaMachine Inc., watched as McCaleb clicked the refresh button on his Web browser again and again. They were waiting for the U.S. Supreme Court to hand down its ruling in the case *Metro-Goldwyn-Mayer Studios Inc. v. Grokster Ltd.*—the record and movie industries' lawsuit against a file-sharing service that let people swap pirated copies of music and films.

Yagan and McCaleb weren't defendants. But they marketed their own file-sharing software, called eDonkey, which had roared past Grokster to become the most popular service in the world. In fact, while few people over 30 have heard of eDonkey, file-sharing on its network accounts for more than one-third of the volume of data sent over the Web, estimates researcher CacheLogic. On average, 3 million people are using its software at any one time to share music and movies. If Grokster lost, they were in deep trouble.

Late that morning they got their answer: The Supreme Court ruled unanimously against Grokster, with Justice David H. Souter writing the company's intent to facilitate illegal activity was "unmistakable." The two at eDonkey were stunned. McCaleb, the company's 33-year-old founder, tapped a few keys, rested his index finger on the enter button of his computer, then looked Yagan in the eyes. "If I hit this button," he said, "we shut the site down. What do you want to do?" The 28-year-old Yagan graduated from Harvard University and earned an MBA from Stanford, but no class could have prepa him for that moment. "What do you when the Supreme Court smashes y business? What do you do when y business partner asks: 'Should I just e it all right now?' "

Yagan and McCaleb didn't end it right then. Instead, they started nego tions with the record industry and po over their options. On Sept. 28, Ya told a U.S. Senate committee he "thrown in his towel" on the dispu service. Now he is trying to reinv eDonkey and use its popularity as a fo dation for a legitimate business.

Future software will have to detect copyrighted songs

NEW LANDSCAPE

ALTHOUGH eDonkey is the biggest, representative of what's happening w other file-sharing services. After Grokster decision, the Recording Ind try Assn. of America (RIAA) sent cea and-desist letters in September to se major services, sending them scrambl to figure out a new business approa What they come up with will determ whether file-sharing becomes a spectable, legal way to market and s music—or whether it persists primarily an underworld of illegal, rated tunes. "The [file-sh ing] landscape in Americ going to be dramatica different just 30 days fr now," says Mike Weiss, C of StreamCast Netwo Inc., which owns the M pheus file-sharing servic

The record industry an interest in eDonkey a its peers pulling off their vamps. Music executi

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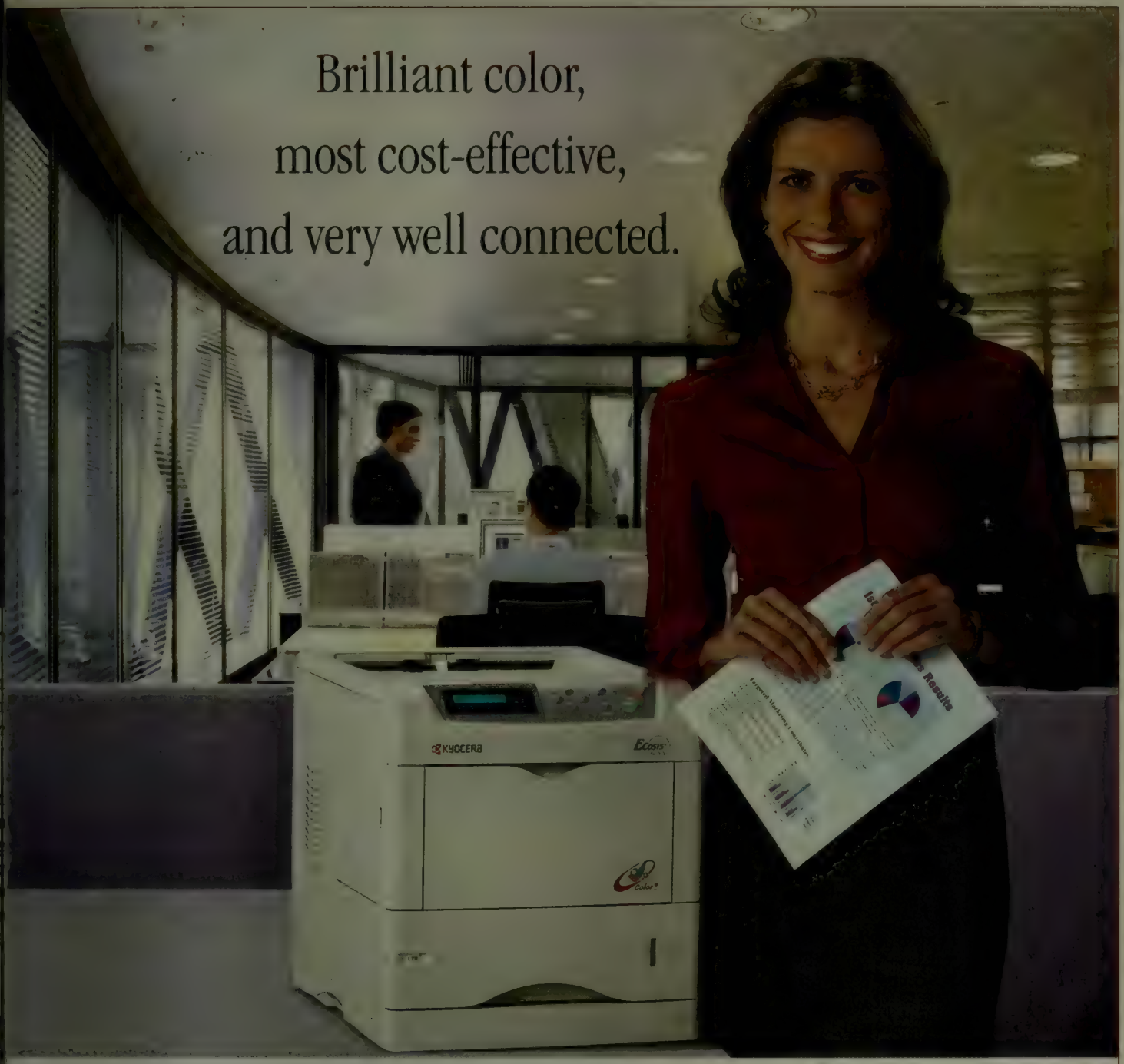

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saw that shutting down Napster, the first major file-sharing service, in 2000 largely backfired. A host of new services sprang up to fill the void for swapping songs. Now, record labels are working with Yagan and others in the hope that legit services will become attractive enough to draw music fans away from systems for piracy. "We think [file-sharing] has great potential and we'd like to see it succeed," says Mitch Bainwol, chief executive of the RIAA. "The key is providing consumers with legitimate alternatives."

No doubt, demand for digital music is taking off. Music downloads, from sites such as Apple Computer Inc.'s iTunes, are expected to generate $875 million in 2008, up from $180 million last year, according to JupiterResearch. Music subscriptions, from Yahoo! Inc. and others, are on track to hit $850 million, compared with $150 million last year.

But can Yagan and eDonkey find a place in the new world of music? They need to muscle their way in between successful legit services like iTunes and Yahoo Music and still-free services like FrostWire that are developed underground by amateurs. An even bigger barrier may be eDonkey's existing software. While the company can avoid being hauled into court by putting out software that complies with the Grokster decision, its millions of users may decide to hang on to their old eDonkey software and continue swapping files illegally. "They are going to have to prove that their value is something other than free music," says David Card, senior analyst at JupiterResearch. "I'm highly skeptical they can do that."

ACADEMIC CRED

YAGAN—ANIMATED, confident, and exceedingly polite—is an unlikely candidate to be running the company responsible for more illegal music and movie transfers than any other. Besides his academic credentials, Yagan is a serial entrepreneur who was given the reins at MetaMachine in 2002 in part due to his success in starting TheSpark.com out of his Harvard dorm room. By paying Harvard undergrads to write *CliffsNotes*-like summaries and analyses of classic works, he stocked his Web site with SparkNotes, a series of free online study guides. The company made money from advertising on the site. Yagan sold the business to Barnes & Noble Inc. for $3.75 million in 2001.

EDonkey, which has continued to offer its controversial service since June, generates revenues in two ways. It sells advertising on one version of its software, which is available to users free of charge. Another, ad-free version is sold to users for $19.95. Virtually everyone opts for the free version, though that means ads flash as they search and download files. Advertising accounts for two-thirds of its roughly $2 million in revenues.

In future versions of its software, eDonkey will have to include technology to detect, and charge for, copyrighted songs. So how can Yagan persuade people to use his software if they can't get the broad selection of free music they're used to? One approach he thinks is promising is akin to broadcast television, where the content is paid for by advertising. He's investigating technology from a startup called INTENT Me Works LLC that lets people downloa song for free if they watch or listen t ad first. Combining that approach eDonkey's many users, he thinks, c create a powerful network.

Another approach takes a page f Mary Kay Cosmetics Ltd.'s market People refer songs to their friends and paid a small fee if their friends buy tunes. Yagan isn't sure the idea fly, but others are banking on it. Impact pays users 5% of the pric a download in store credit i friend buys a recommended so While the fees are only a few ce Greg Kerber, CEO of WurldMe Inc., which makes Peer Impact, s they foster loyalty. "I invested i Dave Matthews song a few we ago," he says. "I've already paid the song and made 32¢."

Yagan is also in serious c cussions to merge his comp with an existing file-shar service called iMesh. The se ice has already worked agreements with all of the m record labels to market t music, and it's developing so networking technology that people set up their own profiles line and communicate w friends. Its music subscript service, which debuts in a weeks, is expected to cost less t $10 a month. If the two compan merge, iMesh would have acces the eDonkey network and will l to convert the user base to its n software. Yagan confirms talks are ongoing but warns t he is still considering seve other options.

Yagan is sanguine that eDon will evolve into something very ferent from what it has been. He cently moved eDonkey's office i Manhattan, since his Hoboken landl wanted to lease the space to another co pany. Stopping into a nearby restaur on moving day, he sips a Corona a scarfs down tuna *tartare*. He looks ti but upbeat. "My colleagues at the ot companies are in a much different p tion in their careers," he says. "I'm years old. I went to Harvard. I went Stanford. This is just a business to me isn't like I've spent my whole life getting this moment." Just then, his cell pho rings. One of the new office's computer on the fritz. He leaves the Corona half-f on the bar and heads back to the office.

–By Burt Helm in Hoboken,

Listen Up

After legal rulings against them, services for sharing music over the Internet are evolving. Here's a look:

NAPSTER The granddaddy of the music-swapping services was shut down in 2000 after a federal appeals court ruling. Napster resurfaced as a legitimate music subscription service in 2003.

KAZAA Once the biggest service after Napster, Kazaa gained a bad reputation for nasty adware. Its user base tumbled. In September an Australian court ruled Kazaa must filter out copyrighted files.

GROKSTER While it gained a high profile as a defendant in a lawsuit that went to the Supreme Court, Grokster's a small player among file-sharing services. After the U.S. Supreme Court decision against it, Grokster is in talks to be acquired by startup Mashboxx.

EDONKEY The most popular file-sharing service on the Net, eDonkey is scrambling to figure out how to go legit. One possibility: It'll merge with iMesh, which combines music downloads and social networking.

THE I'M TIED TO MY DESK ERA IS OVER.

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Love Those Boomers

Their new attitudes and lifestyles are a marketer's dream

BY LOUISE LEE

ILLUSTRATIONS BY ANITA KUNZ

WHEN VESPA MOTOR SCOOTERS CAME PUTTERING BACK INTO THE U.S. MARK in 2000 after a 15-year absence, managers at the Italian company figured th biggest customers would be twentysomethings looking for a cheap way to around. But execs at parent company Piaggio noticed something odd as th scootered back and forth to their Manhattan offices: The most enthusiastic si walk gawkers were often aging baby boomers who remembered the candy-c ored bikes from their youth. It turns out that boomers have lost none of their fection for Vespa. Better yet, now they can afford to buy top-of-the-line mod with all the trimmings. Much to the company's surprise, consumers age 50 a older now buy a quarter of the scooters Vespa sells in the U.S. Managers figu that as they do a better job of marketing to the group, that portion could gr to as much as a third. Those aging consumers may in many ways be the perf customer for an indulgence like a scooter. "The boomers are particularly tractive because they tend to have free time," says Paolo Timoni, CEO of Pia gio USA. "They're less likely to be raising young children, and their careers a established and stable."

The massive postwar boomer generation that drove every significant cultu and marketing trend for 50 years—from Howdy Doody to the Beatles and the Fo Explorer—is defying marketers' expectations about how it wants to live and sho As boomers head into their 60s starting next year, this generation, which grew with the mass market and witnessed the rise of network TV and then the Intern is once again forcing marketers back to the drawing board, this time

rethink the rules for reaching graying customers.

But it matters now because half of the 77 million boomers—people born between 1946 and 1964—will be 50 or older this year. That's the age at which marketers traditionally lose interest in consumers, believing that their choices about which brand of toothpaste or which car to buy have long since hardened and that their biggest earning and spending years are behind them. In the network TV business, where marketers are still fixated on viewers 18 to 49, folks older than 50 are literally dubbed "undesirables."

Elsewhere, though, attitudes are changing—and fast. With average life expectancy at an all-time high of 77.4 years, more and more Americans over 50 consider middle age a new start on life. Fewer than 20% say they see themselves stopping work altogether as they age, according to a recent Merrill Lynch & Co. survey of boomers. Of those who plan to keep working at least part-time, 67% said they'll do so to stay mentally active, and 57% said to stay physically active. People now in their 50s may well work longer than any previous generation, with more than 60% of men age 60 to 64 expected to be in the workforce in 2012, up from about 54% in 1992, according to the Bureau of Labor Statistics.

The boomers' collective wallet will only get fatter as they continue working. As a group, people age 50 to 60 are flush, with more than $1 trillion of spending power a year, about double the spending power of today's 60-to-70-year-olds. They're likely to be vigorous consumers as they empty the nest, take on new jobs, relocate, support children they had in their 40s, go back to school, start a second or third career, remarry, inherit money from their savings-minded parents, pursue new hobbies, and tackle the health issues of aging. "Marketers are slowly waking up," says Matt Thornhill, president of

Baby Boomers Are Teaching Marketers What Rea

	BRAND PREFERENCES	ACTING THEIR AGE
OLD THINK	When consumers hit age 50, their brand preferences are mostly locked in.	Aging boomers are obsessed with looking 20 years younger.
NEW THINK	With kids gone, second careers starting, and divorces common, boomers are open to new experiences—and products.	Sure, cosmetic surgery is popular, but so is being proud of experience and worldliness. Gray hair a wrinkles are O.K., too.
ON THE GROUND	52% of boomers say they're willing to change brands, the same percentage as in the total population.	Gap found out its *Sex and the City* fashions didn't Now it's starting a chain for boomers.

O Assume that
oomers are open-
inded, have a lot of
sposable income,
d will try new
ands.

ON'T Assume
ce a Toyota buyer,
ways a Toyota buyer,
that Boomers shy
vay from new
chnology.

Boomer Project, a Richmond (Va.) sulting firm. "If you're going to ex- d your business, you will have to mar- o the aging boomer."

itching to folks beyond the tradition- t-off point of age 50 could help com- ies bridge the gap between the mer generation and Generation Y, the p of 74 million teens and young wentysomethings that's almost as large as the boomers but hasn't yet reached its big earning-and-spending years. In contrast, the group in between the boomers and Generation Y, known as Generation X, comprises only about 50 million people. "Gen Y is a big market, and its spending power will be even bigger in the future. But what t the shopper today?" asks Greg oney, CEO of the shopping-center agement business at real estate firm s Lang LaSalle, which is altering the store mix at some of its malls to include more boomer-friendly shops.

Figuring out how to reach the new fiftysomethings takes some effort. David G. Schreiner, vice-president for active-adult business development at Pulte Homes Inc. and its Del Webb retirement-community division, suspected that many of the "retirees" living at his properties, where the average age of residents is 62, weren't exactly pursuing the tranquil lifestyles that the company had promoted in the past. Concerned that Del Webb might be misreading its customers, Schreiner last year dispatched staffers up and down the country to interview almost 100 Del Webb residents from Florida to Minnesota.

The reports from the field were even more colorful than Schreiner had imagined. One Florida retiree had gone back to work driving a boat at Walt Disney World and had recently gotten married... at the amusement park. A former telephone company middle manager living at a Del Webb development in Northern California described her life's mission as being "to teach all the world to dance." She leads countless classes and dance events at the retirement community and elsewhere. Another Del Webb resident took up propagating water lilies and breeding them in the many ponds that dot her development in Texas. Clearly these folks weren't just hanging around and playing bingo.

What does that mean for Del Webb's business? Years ago common areas in its communities had a "sewing room" or a "computer room." Now, given that residents might use an area for yoga one day and woodworking the next, rooms are simply named after local landmarks, such as the "Gila" room at the Surprise (Ariz.) development, named after a nearby river. Past Del Webb ads portrayed retirement as a reward for a lifetime of hard work and sacrifice; photos featured people contentedly lounging by the pool. Today, Del Webb presents retirement as a second life with ads showing seniors pursuing their hobbies, exercising, volunteering, or operating a home-based business. "We have to keep up with residents and make sure that we're not building shuffleboard courts," says Schreiner, 52. "The War Generation was far more predictable and consistent, but this generation gives you a bunch of paradoxes."

Vespa still works hard to create buzz among its 30-and-under customers. But it also is pursuing older buyers more aggressively. To increase Vespa's visibility among mature consumers, the company has just begun advertising on the Golf Course Home Network, a Website aimed at affluent boomers seeking homes near golf courses. It's also pursuing cross-marketing deals with mobile-home makers and condominium developers that attract the 50-and-up crowd. To make its scooters more appealing to boomers, Vespa has ratcheted up quality and added a full line of high-end accessories including leather seats and decorative chrome bars that appeal to older tastes and wallets.

Even as companies bend over backward

How to Sell to Boomers

"Companies Need To Take Note": Marketing consultant Matt Thornhill talks about why advertisers who ignore boomers do so at their own peril

A New Wrinkle: Take a look at ads aimed at the graying set.

Quiz: What's the term for TV viewers age 50+? How old was Christie Brinkley when she was dropped as Cover Girl's Cover Girl? Test your knowledge of the baby-boom generation.

Get the story on the Cover Story: For a podcast interview with Marketing Editor David Kiley by Executive Editor John A. Byrne, go to businessweek.com/search/podcasting.htm

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kes Them Tick

G ACTIVE	HEALTHY AND HAPPY
g the days until retirement. Bingo and shuffleboard.	Sell them remedies to treat the aches and pains of aging.
longer, perhaps trying out a new career or starting siness. Maintaining a wired life. Gym workouts.	Focus on wellness. Healthy foods and supplements are in. It's not just about living longer; it's about living better.
oomers say they will continue to work past 60.	Sales of Kellogg's Smart Start cereal are up 48% in one year after being repositioned around a "successful aging" strategy.

DO Tailor products and store design to boomers.

DON'T Assume most boomers want to dress and shop where their kids do to appear younger.

to address older consumers, 66% of people aged 50 to 60 still agree with the notion that, overall, "advertisers target people younger than I am," according to the Boomer Project. But today's boomers, with their numbers, spending power, and high-energy lives, will probably force their way on to marketers' radar screens and stay there. "Our generation still has more living to do," says Nancy Blaustein, 55, of Walnut Creek, Calif., an enthusiastic shopper for all sorts of merchandise from clothes and home furnishings to computer equipment and magazine subscriptions. "I'm not ready to wind down yet." For those companies targeting the boomers, here are five lessons:

I'M A GROWNUP, NOT JUST A BIG KID

YES, OUR CULTURE worships youth. But that doesn't mean boomers fantasize about being 20 again. In fact, that assumption has caused some notable marketing mishaps. In 2001, Mitsubishi Motor Sales of America Inc. began running ads featuring people in their twenties grooving to indie rock music. It turned out those ads alienated the 40-to-55-year-old customers Mitsubishi coveted. Much to the carmaker's dismay, in two years the average age of its buyers had dropped to about 35 from 40. That's bad news because 40-to-55-year-olds tend to have better credit scores and buy more expensive cars than 20-to-35-year-olds. Mitsubishi reto the ads, casting fortyis tors. "We literally had e ing, valuable custo who were dropping us consideration because said they no longer themselves in our bra says former Mitsu marketing chief Ian Be now head of marketin Kia Motors America In

Gap Inc., too, thinks aging boomers will co ue to be a profitable ment of consumers so as the company do group them with shop half their age. Four y ago the core Gap b tried to revive flagging s in part by capturing the plus consumer. An ad c paign using the tag "For Every Generati featured artsy black-a white shots of famous o boomers, including a Bill Paxton and S Spacek. But the inclu slogan and mature f didn't make the Gap b grown-up.

Most of the camp still focused on you celebrities, and G clothes themselves mained too bright skimpy for the boomer body. Sales tinued to decline. San Francisco-ba Gap is now launching a chain ca Forth & Towne, selling careerwear casual clothes aimed at U.S. women er than 35 (BW—Oct. 17). "All their li the boomers have been catered to felt special, and they would like to something just for them," says Geof E. Meredith, president of market consultancy Lifestage Matrix Market in Lafayette, Calif.

Still Booming After All These Years

Here's a look at the enormous postwar generation as it edges toward retirement

Number of boomers	Percent of U.S. population	Estimated annual spending power	Total number of households	Annual average household pretax income	Annual average spending per household	Poverty rate
77 million	27.5%	$2.1 trillion	45.8 million	$57.7 thousand	$45.7 thousand	7.3%

Data: MetLife Mature Market In

WORK
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gest U.S. provider on
bal standard.

EXPERTISE
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APPLICATIONS
The broadest and deepest portfolio of wireless business solutions.

SERVICE
24/7 enterprise-grade support. And a service staff dedicated solely to business people.

real time gets Corporate Express there in no time.

With its 24/7 dedicated business service team, Cingular gave Corporate Express the support, training, and technology needed to migrate from a paper-based delivery system to a real-time wireless solution. From system installation and operation to employee training, the Cingular service team ensured a seamless transition to the ALLOVER™ network, the largest digital voice and data network in America. For the leader in office supplies, Cingular increased driver productivity while reducing administrative costs.

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FIFTYSOMETHING CAN BE BEAUTIFUL

COMPANIES HAVE traditionally used models in their 20s with dewy skin to pitch products made for middle-aged women. The rise in Botox treatments and plastic surgery notwithstanding, many consumers experiencing their first liver spots and crow's feet are actually comfortable in their skins and pleased to see people who look like them in ads. "As you become older, you're clearer and more comfortable about who you are," says Lori Bitter, partner at JWT Mature Market Group, part of J. Walter Thompson Worldwide. "It's a reality of aging. We want the message at eye level. We may not want it sugar-coated."

Portraying advancing age has helped Unilever Group's Dove soap. About 18 months ago, Dove market researchers suspected that advertisers were stuck in the old habit of presenting only youth and slimness as attractive. To confirm that idea, they pored over video clips of commercials and leafed through pages torn from magazines, pasting them up into photo collages. And indeed, the result was a shrine to the slim, the full-chested, and the young. Then, because Dove is a global brand, the researchers trekked across the U.S., South America, Europe, and Asia to ask thousands of women of all ages what they thought of the portrayal of beauty in advertising. No matter the country, they repeatedly heard the gripe that "the images of beauty in ads are unrealistic and unattainable," says Dove marketing director Philippe Harousseau.

Capitalizing on that sentiment, Dove turned industry tradition on its head last October with print ads using ordinary looking women instead of glamorous models. Two of the six shots in the ad exult in advancing age. One shows a 46-year-old woman with deep lines around her jaw and eyes and a full mane of gray hair. The caption: "Why aren't women glad to be gray?" The payoff so far: In the nine months following the launch of the campaign, sales of Dove rose 3.4% from a year ago. That uptick sounds small, but it's huge for the static soap category, and it exceeds the growth in soap sales as a whole, according to Information Resources Inc., which doesn't include sales at Wal-Mart Stores Inc. in its data. Why is the campaign working? "As you get older, fantasy and idealization are out, and reality and authenticity are in," says James J. Gilmartin, president of ad agency Coming of Age Inc. in Lombard, Ill.

Even cosmetics marketing, which has most adamantly equated beauty with youth, is starting to change. Procter & Gamble Co.'s Cover Girl brand, where women older than 55 account for about 20% of sales, has just launched its first line of makeup aimed at older women. The name of the product, Advanced Radiance Age-Defying Makeup, hints that adv ing age can be pretty. And while ads show a stunningly gorgeous face, that belongs to an older woman: 51-year former supermodel Christie Brin Cover Girl marketing head Anne Mart betting that bringing back Brin who represented the brand for decades until 1996, will help C Girl recapture boomer women were customers in the 1970s '80s. Like many of today's fift consumers, Brinkley is known being energetic and active. " represents the new 50-year-o says Martin.

DO Appreciate that boomers are comfortable aging but that they want to look and be healthy.

DON'T Think they all want to be 25 again.

I'M NOT AS SET IN M WAYS AS YOU THINK

MANY MARKETERS believe consumers' brand preferences locked in by age 40. That mi have been true for previous gen tions. But today's over-50 crowd is as likely, and in some cases more lik as everyone else to try differ brands within a product categ According to Yankelovich I 33% of consumers older than agree that it's "risky" to buy unfamiliar brand. That's than the 36% of resp dents aged 16 to 34 only a little more t the 30% of people a 35 to 49 who agree w that notion.

In some categor older consumers even more willing brand-hop than youn ones. According to 2004 survey by Leo J. Shapiro & Asso ates LLC for *DSN Retailing Today*, 48% shoppers aged 50 to 59 said they wo probably switch brands of consun electronics, compared with 40% of all spondents. And 56% of people in t group would try another brand of heal and-beauty product, more than the 5 figure overall.

What gives? That flexibility stems fr the fact that today's fiftysomethings ca of age in the 1960s culture of unlimi possibility. "This group grew up in a ti when novelty and experimentation w higher on the priority list than during t prior generation," says Yankelovich Pr ident J. Walker Smith. That attitu means a 50-year-old boomer just mig try that new product or service. On the side, such open-mindedness also c

Controlling Diabetes

Fulfilling Dreams

Science For A Better Life

Millions of people face the shock of diabetes diagnosis every year. Some 189 million worldwide live with the disease. Many of them are children, whose quality of life suffers a serious setback.

Thankfully, diabetes has become largely controllable – but it is crucial to know how to manage it if secondary illnesses are to be avoided. This depends on regular, accurate measurement of blood sugar levels.

Bayer HealthCare is working to make testing easy, quick and safe. Using a device that measures blood sugar in a matter of seconds, for example.

That's the best basis for successful treatment – and the foundation for enjoying as normal a life as possible. www.bayer.com

New Bayer: CropScience MaterialScience HealthCare

make these consumers highly unpredictable. Honda Motor Co. thought minivans were just for 50-and-under soccer moms and figured that its boomer customers, once free of the children, would move on to its fancier Acura coupes and sedans. But to its surprise, 40% of Honda minivan buyers are empty-nesters, mostly boomers over 50 who want roomy vehicles to cart around grandchildren, elderly parents, and Home Depot hauls. Honda last fall introduced an upgraded Odyssey minivan full of leather and featuring zoned climate control and other pricey features wealthier older buyers covet.

I'M REWINDING, NOT WINDING DOWN

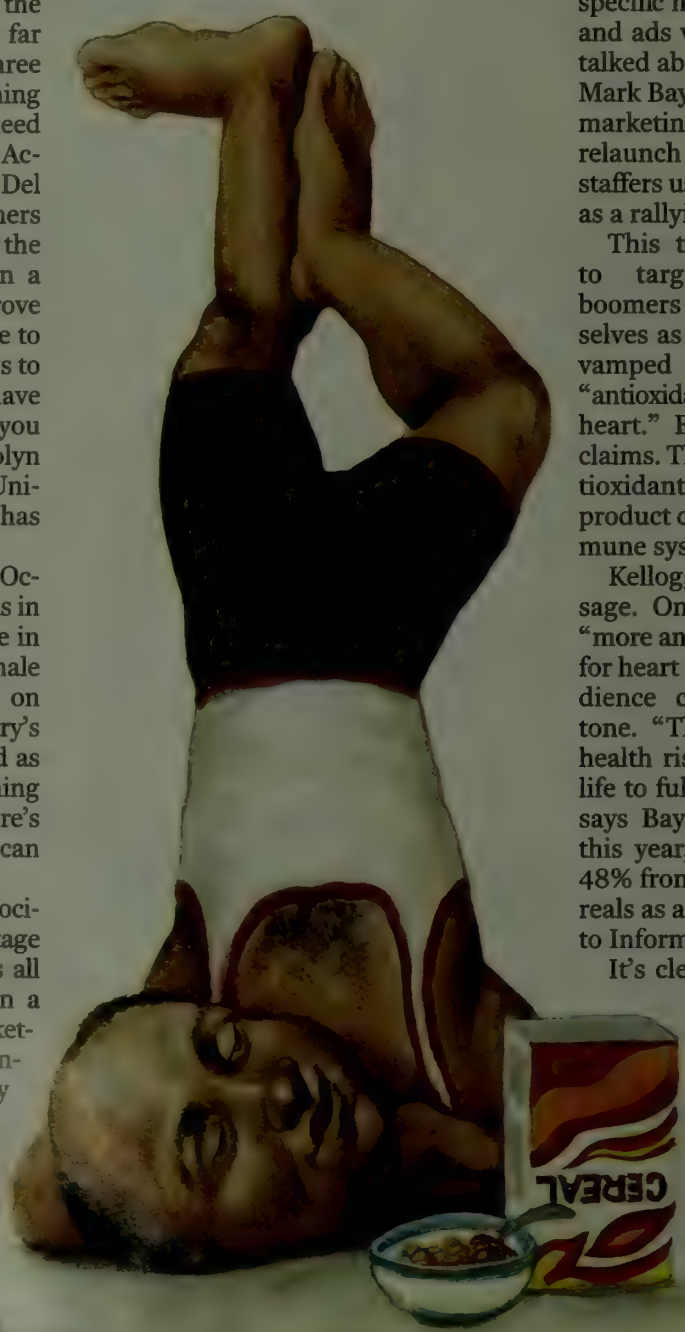
FOR PREVIOUS GENERATIONS, age 50 meant, bluntly put, the beginning of the end. But today's 50-plus crowd is far more likely to see the two or three decades ahead as a second life. Watching the kids leave home, for instance, need not bring on empty-nest syndrome. According to a survey last year by Del Webb, more than three-fifths of boomers say they're emotionally prepared for the kids to leave home, and more than a third believe their marriage will improve after the kids leave. "You'll have time to talk to your spouse more, fewer things to argue about, and you don't have to have sex in the middle of the night when you think the kids are asleep," says Carolyn E. Adams-Price, a Mississippi State University psychology professor who has studied empty-nesters.

Seizing on that idea, Pillsbury last October began airing a TV spot that revels in sexy empty-nester coupledom. "We're in this experimental phase," says the male half of a fiftyish twosome snuggling on the couch. The couple savors Pillsbury's Oven Baked biscuits with dinner, and as the Pillsbury Doughboy dims the dining room lights the woman giggles: "There's only so much experimentation I can take... at least at the dinner table."

The strategy, Pillsbury says, is to associate the empty nest with a promising stage of life. "Marketing to this segment is all about portraying the empty-nester in a positive light," says Mark Toth, a marketing manager at Pillsbury, a unit of Minneapolis' General Mills Inc. Pillsbury could be on to something: After only three years on the market, its frozen biscuits have the largest market share in that product category and sales are up since the campaign changed direction.

DO Communicate health benefits of products boldly and precisely. Many boomers are amateur nutritionists.

DON'T Use vague advertising claims such as "fortified with vitamins and minerals" or "fast pain relief."



I WANT TO LIVE LONGER AND HEALTHIER

HEALTH ISSUES WEIGH heavily on mind of the 50-year-old boomer. The concern about retirement in a Met Inc. survey was "becoming sick," 31% of respondents citing that is Drug companies, of course, have alw tried to cash in on the health concern older consumers. Now other kind companies are joining in.

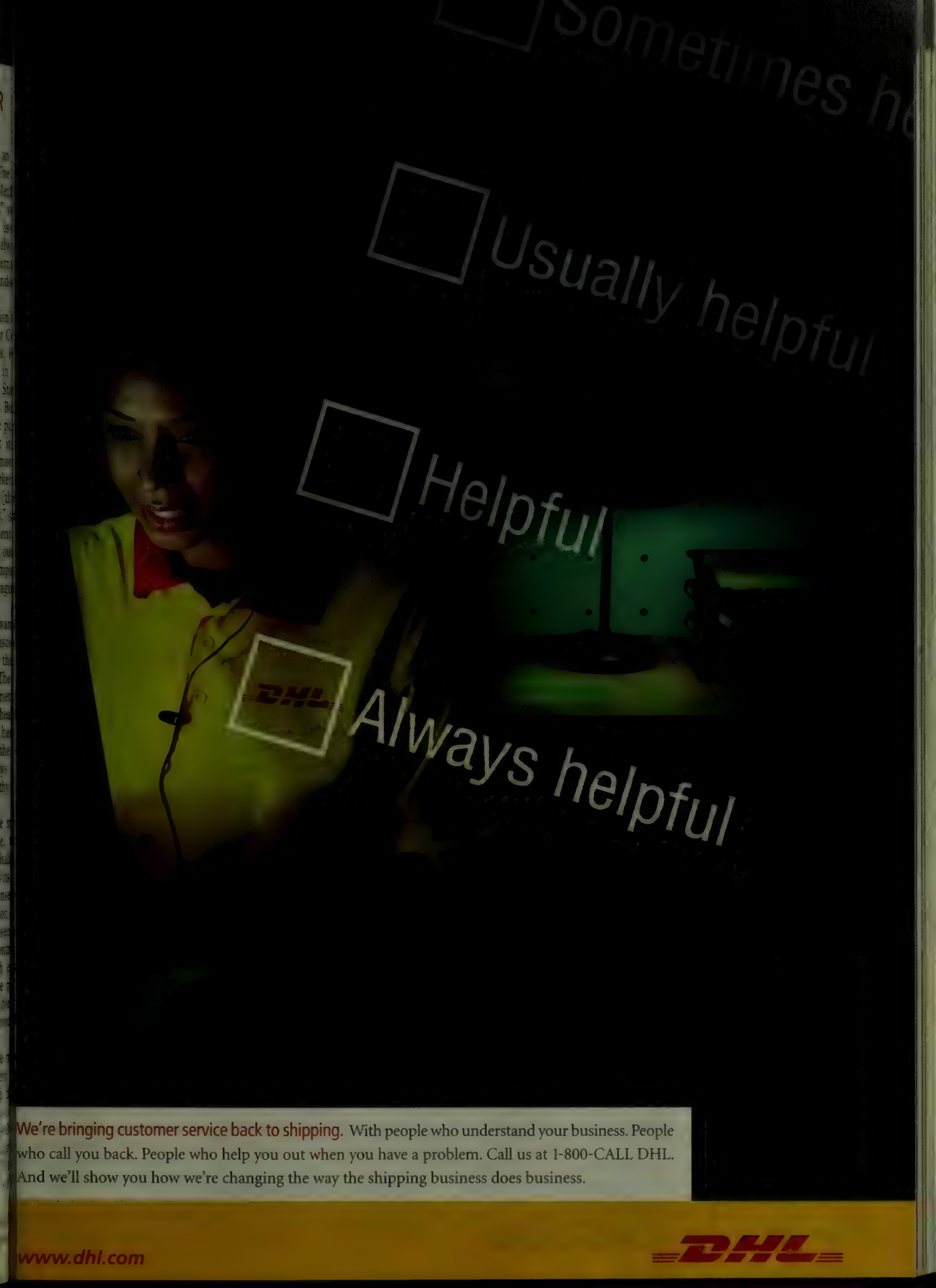
But catering to health worries isn easy as it looks. Long known for C Flakes and sugary kiddie cereals, logg Co. in Battle Creek, Mich., in late 1990s launched its "Smart St line, designed for older grownups. B languished for years because the p aging, marketing, and product it weren't aggressive enough in promo specific health benefits. "The marke and ads were generic in the way [th talked about vitality and vitamins," Mark Baynes, a senior vice-president marketing. Last year, Kellogg set ou relaunch the line. Inside the comp staffers used the term "successful agi as a rallying point.

This time around, Kellogg wan to target older, health-consci boomers who increasingly see th selves as amateur nutritionists. The vamped line includes three variet "antioxidant," "soy protein," and "hea heart." Each pinpoints specific he claims. The front of the box from the tioxidant line, for instance, says product can "help support a healthy mune system."

Kellogg doesn't soft-pedal the m sage. One ad says, for example, "more and more women are hospitali for heart disease." Kellogg figures its dience can handle the no-nonse tone. "They're more educated on health risks, and if they have a sec life to fulfill, they have to take contr says Baynes. Since the relaunch e this year, Smart Start sales have ri 48% from a year ago, while sales for reals as a group slipped 0.2%, accord to Information Resources.

It's clear that the boomers are m comfortable with their than marketers give th credit for. "It'll be cool be gray," says consult Meredith. Once compan pick up on that, they'll s to see green amid the silv tones. ■

–With David K in New Y



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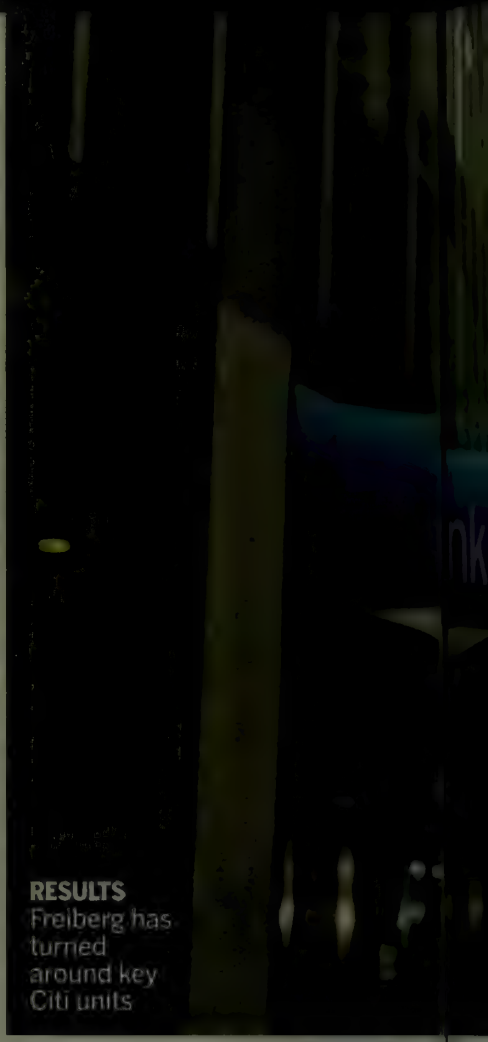
Thinking Locally At Citigroup

The global giant is an also-ran at home. How Steven Freiberg plans to change that

LIKE POLITICS, ALL BANKing is local—even for mighty Citigroup. While Citi's $1.5 trillion in assets make it the world's second biggest bank, U.S. retail operations are hurting. Basically, Citi is being left in the dust by aggressive and expansion-minded rivals. Its 3.4% share of nationwide deposits is just over one-third of the acquisitive Bank of America Corp.'s 9.8% share, for example. Last year, that widening gap pushed Citi out of the catbird seat it has occupied for years as the world's largest bank as measured by deposits. And its revenues of about $15 billion from U.S. retail banking were flat in the first half, while BofA raked in a record $14 billion, up 23%.

Citi's domestic problems run deep. Most of its 34 million customers buy fewer products or services, such as a credit card, mortgage, or checking account, than clients at rivals like BofA or Wells Fargo & Co., which makes Citi less profitable. It's a lowly seventh in the giant mortgage and home-equity business, about one-third the size of market leader Washington Mutual. Citi's retail bank is limited in geographic reach, and U.S. credit-card account growth has stagnated. The result: a global institution that is essentially a New York bank at home, with 60% of its deposits coming from the region—and one with a reputation for "below average" customer service, according to financial consultants A.T. Kearney. Says Merrill Lynch & Co. bank analyst Guy Moszkowski: "They are very clearly getting upstaged in the U.S. If they don't find a way to grow faster, or if the business shrinks because of competition, that's a big problem."

The task of kicking up growth falls to Steven J. Freiberg. In August, Chief Executive Charles O. Prince picked him to head Citi's retail banking operations in the U.S. and Canada, newly carved out from the global bank. In the old days, Citi would have bought growth with a few big deals. But Freiberg doesn't have that option. The Federal Reserve, leery of Citi's series of worldwide regulatory run-ins since 2002, has banned the bank from making major acquisitions for now. "If we're going to grow, we can't rely mainly on the old acquisition model anymo We are taking a much more focused vi of organic growth," says Freiberg.



RESULTS Freiberg has turned around key Citi units

As he sees it, Citi has plenty of cu tomers. He mainly needs them to b more stuff. So Freiberg's first big push to mine the bank's 120 million credit-ca customers—along with 18 million n ones annually—for mo business. If he can sell least one bank product one in 20 of them, he sa he can double the ret bank's profits. Al Freiberg wants to step marketing to profession such as doctors a lawyers, as well as small-business owners a CitiGold bank custome These so-called mass aff ent clients with at le $100,000 in assets are potential goldmine. He f ures that every new pro uct they buy, say an au loan or a mortgage, yiel 12 times the profits of t first sale simply becau the cost of recruiting n customers is so high.

Home Field Disadvantage

Citigroup is the second biggest bank in the world, but rivals have pulled ahead in the U.S. Here's the brief for Steven Freiberg, co-head of Citi's Global Consumer Group, North America:

PROBLEM	REMEDY
Languishing market share with just 3.4% of U.S. deposits vs. Bank of America's 10%; reliance on New York, with 60% of deposits	Refurbish branches and build new ones; acquire small banks in fast-growing markets such as Texas, Florida, and California
Skewed focus on product lines such as loans and checking accounts rather than customers; below-average service in branches	Weld Citi's 130,000 Primerica agents, 2,200 consumer finance offices, and 884 bank branches into a unified distribution channel
Untapped potential for selling more services and products to credit-card and retail bank customers	Target groups such as doctors, lawyers, and top-shelf CitiGold bank customers with more than $100,000 in assets

Data: *BusinessWeek*

low growth in deposits may crimp berg's ambitions. Citi ranks seventh, nd BofA, Wachovia, JPMorgan se, and Washington Mutual, in retail sit growth for the last 12 months, ac- ling to SNL Financial in Char- esville, Va. This matters because de- ts are the launch pad for more ative customer relationships. At A, which has the largest market share, e than half of its customers buy more one product. Only one in five do so at , according to Prudential Securities bank analyst Michael Mayo. Because bank has underinvested in recruiting training, customer service—and so sit growth—has suffered. "Retail king economics are overwhelmingly inated by deposits," says James M. ormick, president of First Manhattan sulting Group in New York.

RD TRICKS

IBERG HAS BEEN in tight spots be- . When he joined Citi's credit-card p in 1997, most Americans were ging up a storm on bank cards, but s business had plunged 25% in a year. 5-year Citi vet who often lands turn- nd assignments, Freiberg slashed and built new models to manage credit risk. He kicked sales into gear with direct mail, pre-approved credit cards—a marketing tactic pioneered by his group that now is standard industry practice. He also built the largest U.S. private-label card business by acquiring the portfolios of Federated Department Stores, Sears, and Home Depot. Last year, cards earned $4 billion, nearly a quarter of Citi's total profits and 10 times more than when Freiberg arrived.

Just six weeks into his new job, Freiberg has already made some big changes. He has restructured the group and created three positions to run distribution, technology, and franchise management. Ray Quinlan, a former executive vice-president at Citigroup Mergers & Acquisitions, now heads retail distribution. His mission: to weld Citi's 130,000 Primerica brokers, 2,200 consumer finance offices, and 884 retail bank branches into a cohesive sales operation. One of Citi's big problems has been that sales and support staff have been organized around products rather than customers. "It's pretty clear that Citi's various consumer businesses in the U.S. have not been integrated in a management or information sense," says Bear Stearns & Co. bank analyst David Hilder.

PLAYING CATCH-UP

IN THE FUTURE, high-end customers will be more cosseted. The effort will be based on an existing rewards program, the ThankYou Network, that lets card and bank customers accumulate points to redeem for purchases at merchants such as Home Depot or Bed Bath & Beyond Inc. Freiberg plans to use technology to track these loyal customers and ply them with discounts and other incentives to buy extra Citi products and services. He's also introducing new cards. On Oct. 17, Citi planned to launch the annual- and late-fee-free Simplicity Card.

Freiberg's effort to attract and retain customers will extend to Citi retail and consumer finance branches as well. By the end of the year, Citi will have built 23 new branches, vs. just 22 in the prior seven years. Still, Freiberg must quicken his pace. Chase, for one, will have built 150 new branches nationwide by yearend. Citi will also have to train branch staff to develop stronger ties to customers. At Wells Fargo, which has done this for years, some 40% of all retail sales come through one of its 25,000 tellers. Wells says that helps it sell an industry leading average of four products to each customer. Says SNL Financial analyst Eric Reinford: "Citi is still playing catch-up to the retail boom of the 2000s that everyone else has been cashing in on."

The risk? As Citi invests big in retail, consumer spending may cool

The timing of Freiberg's push is tricky. Citi may be investing big in retail just as U.S. consumers' spending habits shift. The mortgage business is cooling, and many are burdened by credit-card debt. In any case, what's happening is a radical change for Citi. By creating Freiberg's position and splitting off domestic banking, Prince broke with Sanford I. Weill's centralized strategy of treating Citi's consumer operations as a global enterprise. While the consumer business overseas is growing at a fast clip, Prince saw that North American retail banking was a separate challenge. As he handed over Citi's lackluster domestic retail operations to Freiberg, Prince tried to brace him for the worst, warning: "Yours is the harder job." ■

–By Mara Der Hovanesian in New York

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Freeport's Hard Look at Itself

The mining giant's gutsy human-rights audit may set a standard for multinationals

FREEPORT-MCMORAN COPper & Gold Inc. has long been tagged as a human-rights pariah for its close relationship with the repressive Indonesian military. In the mid-1990s, for example, it was linked to horrific acts allegedly committed by the Suharto dictatorship against rebels unhappy about expansion of the company's gold and copper mines on the Indonesian island of Papua. Allegations against the troops included all manner of atrocities, including torturing and murdering protesters, as part of what some critics called a genocidal war against separatists in what was then known as Irian Jaya. Activists accused Freeport of complicity, charging that the New Orleans company's security personnel routinely provided transportation for the Indonesian military.

Freeport has always denied knowledge of abuses, but it has nonetheless engaged in a gutsy human rights review that could become a model for all Western multinationals. In 2003 the company quietly asked an outside nonprofit to conduct an independent audit of its vast Papuan mining complex. A report of the International Center for Corporate Accountability I (ICCA), which examined the 18,000-wo er operation, is set to be released on Oct (The full 133-page audit and Freeport's sponse, both of which *BusinessWeek* tained from the ICCA, will be posted www.icca-corporateaccountability.org.)

Two years in the making, the rep details a raft of problems. Although t egregious military abuses have stoppe the ICCA found lingering issues, from olations of Indonesian laws governi its contract workers to rampant m management of a much-praised fu Freeport started to help local Papu tribes (table). Some of the findings ev stunned Freeport management. For stance, top execs had no idea that 700-person in-house security force co tinues to drive Indonesian milit around—a practice management thoug it had stopped after the mid-1990s' o cry, say ICCA officials. The ICCA did look into long-standing environmen abuses charges against Freeport.

In a formal reply to the audit, Freep acknowledged the problems and vow to address them. "We haven't accep

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all the recommendations because some aren't culturally the right way to go about it, but the findings are right," says Stan Batey, Freeport's senior adviser on community relations.

The company's willingness to open up so wide is a major development in the corporate responsibility movement. Certainly, no other global mining or oil company has come close to such transparency, long a key demand by human-rights groups. A few consumer products companies—such as Nike, Liz Claiborne, and Toys 'R' Us—invite independent scrutiny of their overseas labor practices, mostly through joint industry-nonprofit groups set up for the purpose. But the Freeport audit surpasses these efforts.

Most companies are closed books when it comes to independent scrutiny. A majority of U.S. multinationals have codes of conduct that promise good behavior in these fields, but there's rarely a way of checking up. Freeport's example could set a new standard. "Having third-party accountability like Freeport's is critical to corporate credibility," says Arvind Ganesan, director for business and human rights at Human Rights Watch. His group, which wasn't involved in the audit, has criticized Freeport over the years.

INSTANT UPHEAVAL

FREEPORT'S AUDIT by the ICCA, based at the City University of New York (CUNY), shows how companies that are willing can open up even in the most challenging environments. The sprawling complex in Western Papua includes the world's largest gold mine and the third-largest copper mine. It sits atop a 14,000-foot mountain that gets 300 inches of rain a year. When the mine opened in 1967, there were no roads and fewer than 1,000 people in the area, mostly tribes recently exposed to industrialization. The mine drew in 120,000 people, some from other parts of Papua, others Javanese, brought in by Suharto—a move Papuans saw as Jakarta's attempt to conquer the former colony. All this thrust the area into modernity overnight. It also caused friction with seven local tribes, and tensions boiled over in the mid-'90s, leading to all the charges.

Freeport responded by vowing in 1996 to quadruple Papuan employment at the mine over a decade. And it set up the Partnership Fund for Community Development, which gives 1% of mine revenues to locals. It will pump in about $25 million this year, bringing the total to $132 million. Freeport later laid out social- and human-rights policies and, in 2003, produced detailed standards.

POKING AROUND ICCA's Sethi, right, talks with Freeport staff

That's when it brought in the ICCA. It was a surprising conversion for a company headed for years by combative CEO James R. Moffett, who relinquished the title last year but remains as chairman. The ICCA got involved at the urging of Gabrielle K. McDonald, a Freeport director who had served as a judge at the International Criminal Tribunal in The Hague, and of David Lowry, a priest who was Freeport's vice-president for social and community relations until he retired in 2004. Lowry says he started with managers at the mine before asking top ex and the board to go along. "We wanted outside audit not to please an external a dience but to figure out how well we w doing on our commitments," says Low

The ICCA's answer: Performance w good in many respects but deficient in o ers. The auditors laud Freeport's hum rights training program, given last year 30% of employees. But interviews show that 60% of those trained couldn't ansv basic questions about the policy. Neit could 60% of security personnel, e though 90% of them had tak human-rights training thr times as long as the four hou other employees got.

It was the employee inte views that brought to light t ongoing link to the milita The ICCA demanded to kn why 29% of the 60 secur personnel chosen were u available. Eventually, it learn they were driving for the mi tary, says ICCA founder Prakash Sethi, a manageme professor at the Zicklin Sch of Business at CUNY's Baru College. "This was agai Freeport's policy and shock all of us," says Sethi.

Even though the ICCA d in deep, it still has plenty work to do. The audit cov about 9,000 employees Freeport and direct subcontractors. T next stage will cover another 9,000 at se ondary suppliers. The ICCA also will mo itor Freeport's follow-up plans.

Critics like Human Rights Watch Ganesan still insist Freeport could ha fixed much of what the ICCA found on own. Even so, Freeport's willingness to exposed puts it in a class by itself. Oth companies facing similar abuse accus tions now may need to follow its exa ple—or explain why they can't whi Freeport can. ■

–By Aaron Bernstein in Washing

Freeport Bares all

The International Center for Corporate Accountability did an exhaustive human-rights audit of its 18,000-worker mining complex on Papua. ICCA found a raft of problems, which Freeport says it will address, including:

HUMAN RIGHTS Nearly 60% of the mine's 700 security personnel couldn't answer basic questions about Freeport's human-rights policies

MILITARY LINKS Top management was unaware that Freeport security forces still drive Indonesian military and police around the mine area—a major issue during mid-1990s' accusations of military human-rights violations

TRIBAL EMPLOYMENT Freeport isn't doing enough to help Papuan tribal members gain skills needed to advance into higher-level jobs

CONTRACT LABOR The company's use of lower-paid contract labor is unfair and sometimes violates Indonesian labor law

COMMUNITY FUND Freeport's innovative $20 million-a-year-plus local development fund—run by tribal leaders—is mismanaged and needs more oversight by Freeport

SCHOOLS The high school dorms operated by the fund are poorly run, often lacking electricity, running water, rest room doors, and safe transportation

Data: International Center for Corporate Accounta

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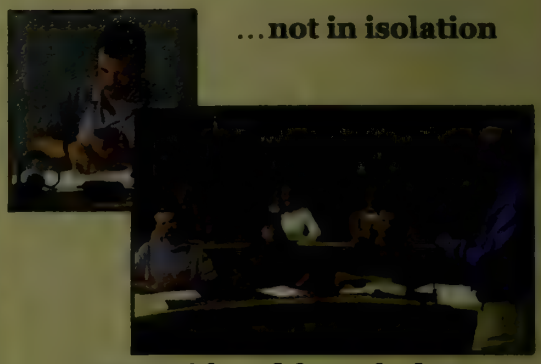

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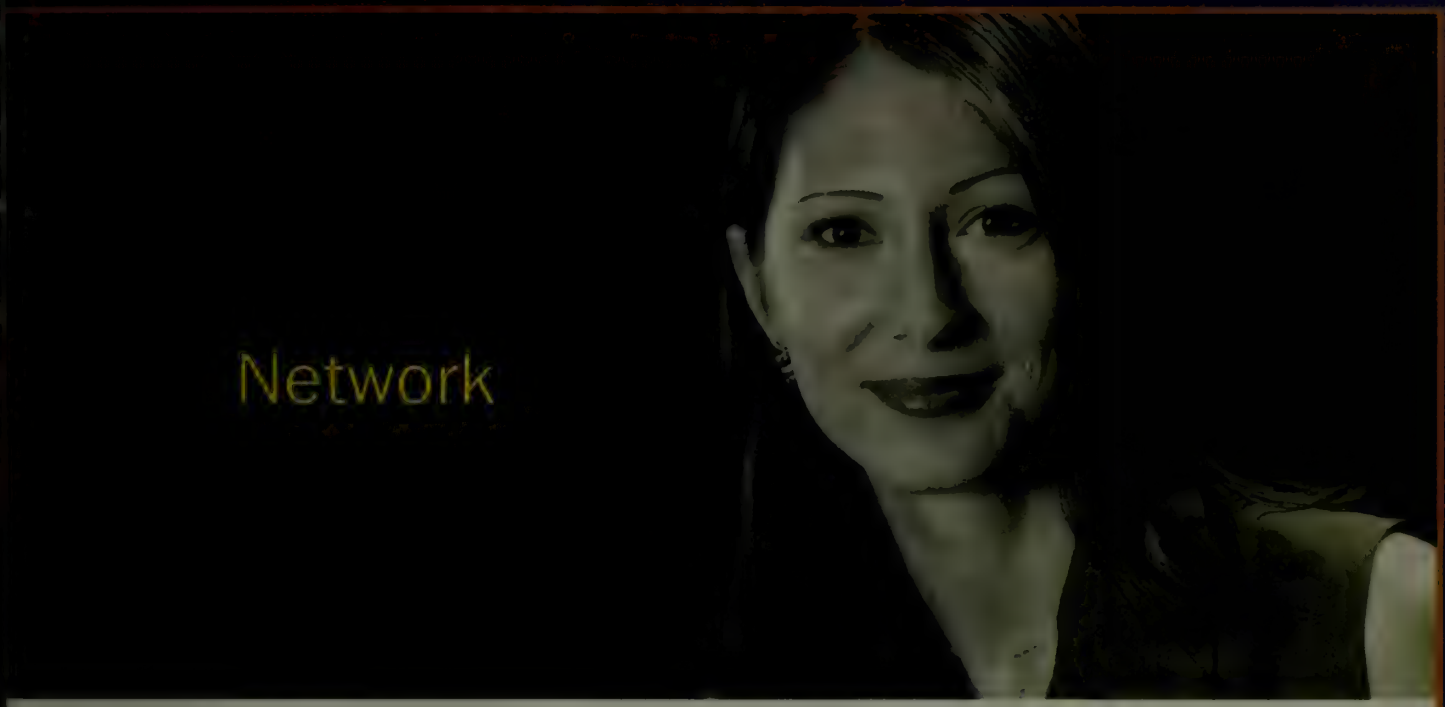

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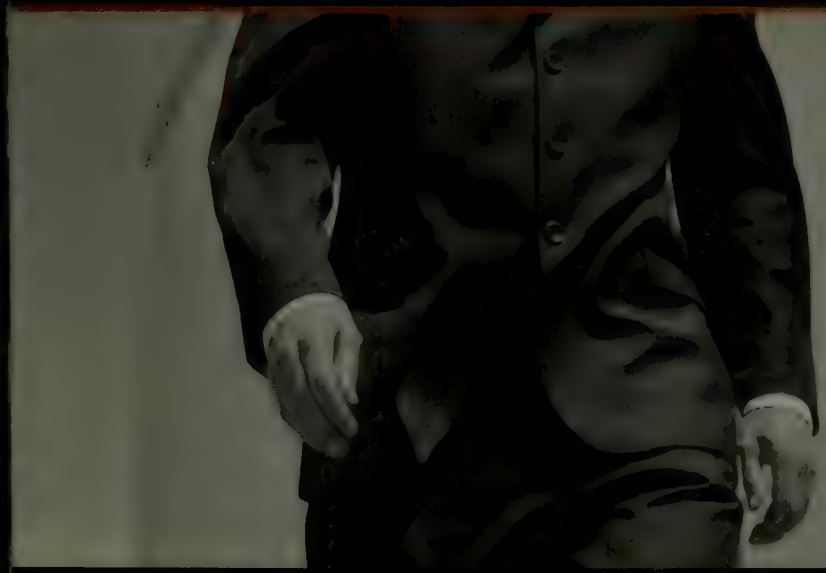

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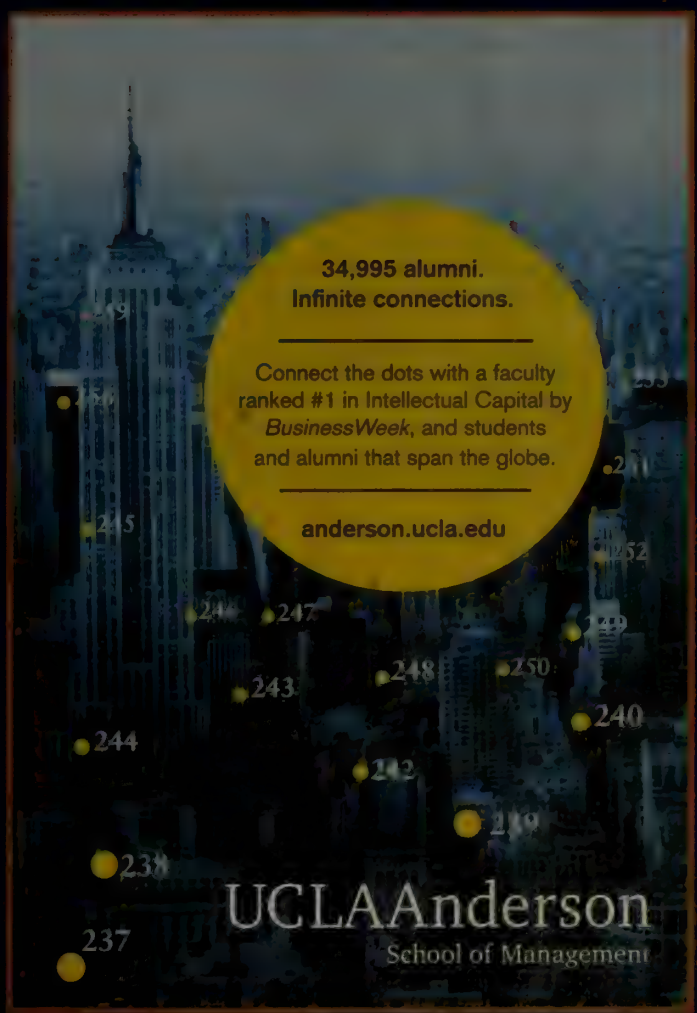

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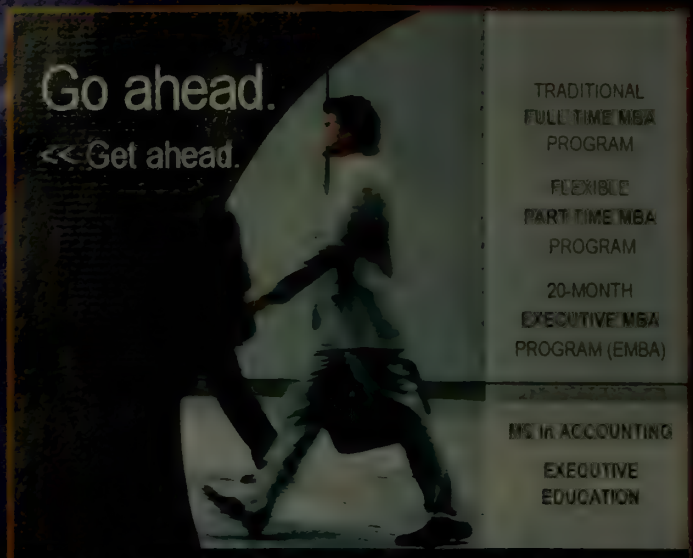

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orking at the company's in Eindhoven, the erlands, Philips archers are testing otypes on synthetic ions and blood. They're working to shrink the able analysis systems to ize of laptop computers, the goal of ging them arket as as 9.

DEVICES

NEW LIFE FOR BATTERIES INSIDE THE BODY

PEOPLE RECHARGE their electric toothbrushes by standing them in a cradle that emits an electromagnetic field. So why not use a similar approach to recharge implanted medical devices?

One product that may soon benefit from this thinking is a tiny device that treats urinary incontinence. The size of an inch-long matchstick, it works by restoring signaling function to defective nerve tissue. The implant, made by Advanced Bionics, is already available in Europe and is undergoing clinical trials in the U.S. The company believes it also could help patients with Parkinson's, epilepsy, and spinal-cord injuries.

Now the goal is to incorporate minuscule batteries developed in a collaboration led by Robert West, head of the University of Wisconsin's Organosilicon Research Center. Since they're recharged simply by a magnetic pad placed on or near the body, the batteries could last 10 years or more before requiring surgical replacement. They might work for larger implanted defibrillators as well.

–Otis Port

CELL PHONES

HOW TO SCAN WITHOUT A SCANNER

EVER FIND YOURSELF paging through a book or magazine at a friend's house and wishing you could just scan it and save it for later? NEC has a way to soup up a cell phone to do this, using 3D imaging software integrated with a digital camera.

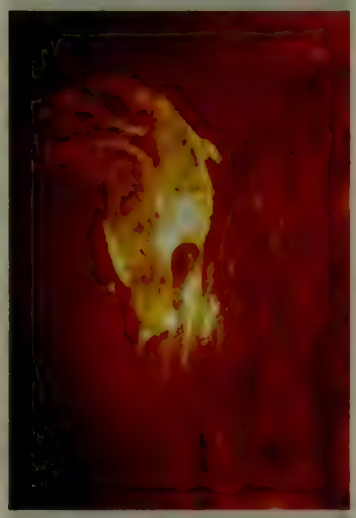
The phone works by taking dozens of tiny snapshots when you wave it across a page in a zigzag pattern. Within seconds, optical character-recognition software in the phone uses the edge of the page as a frame and knits together the overlapping snapshots into a seamless whole. It can even detect when the page isn't lying flat and straighten a distorted image.

NEC says it may also bundle some phones with Adobe Systems' popular Acrobat document software. And to ease publishers' fears that people will start scanning everything in sight, NEC could embed sound effects that can't be muted, which announce when scanning is in progress. Sales could begin within two years. *–Kenji Hall*

INNOVATIONS

Of solar flares and the rush on genes

>> Most people equate solar flares with radio blackouts and adverse weather events. But it turns out they do good, too. Measurements taken on the International Space Station in September indicate that when flares erupt, they shoot out not only massive streams of hot gases but also magnetic fields. These deflect cosmic rays that would otherwise pose potential hazards for



astronauts in orbit. A single eruption can lessen cosmic rays for weeks at a stretch, the scientists report.

>> Like settlers in the Oklahoma land rush of 1889, private and public entities have staked claim to 20% of the human genome, report two researchers at Massachusetts Institute of Technology. Of the more than 4,000 genes protected by patents, nearly two-thirds are owned by corporations, and 28% belong to universities, the two say in a paper to be discussed on Nov. 1 at the annual meeting of the American Institute of Chemical Engineers. Most of the patented genes are associated with cancer.

A Bad Case of Sticker Shock

Next year's health benefits will cause you to say "Ouch!" Here's what the most important changes will look like–and how painful they'll be.

BY LAUREN YOUNG

IF YOU WORK FOR A COMPANY that starts its fiscal year on Jan. 1—and 70% of employers do—the 2006 benefits package should soon hit your mailbox. Brace yourself for sticker shock: You may even feel a little sick when you see the combination of higher costs and reduced coverage. ¶ That's because your employer is paying an average of 8% more, an extra $600, for your health insurance in 2006, according to human resources consultant Towers Perrin in Stamford, Conn. And since employers are foisting more of the burden off on employees, your tab will go up even higher: an average $155 more for health care in 2006, up 10% from 2005. ¶ To keep costs in line, there's a good chance you'll be offered the option of a high-deductible plan that lets you choose how you spend your health-care dollars. You can also expect to see higher costs for prescription drugs and larger deductibles. Also new: More companies are offering financial incentives to participate in wellness studies. ¶ Here's a look at some of the key changes to 2 benefits plans and what to consider fore signing up:

» HIGH-DEDUCTIBLE ACCOUNTS

JUST A FEW YEARS ago, these pla which make the employee responsibl a bigger portion of their medical cos exchange for a lower premium—v scarce. Now 20% of employers off high-deductible plan, according to Henry J. Kaiser Family Foundation. Herschman, a health-care consultan Mercer Health & Benefits in Clevel predicts that half of the companies 5,000 or more employees will offer a h deductible plan next year, in additio more standard choices such as indem point of service, and health maintena organization (HMO) plans. Some sm companies may even replace convent al plans with high-deductible version

High-deductible plans come in two vors: health reimbursement acco (HRAs) or health savings acco (HSAs). The key difference is the H is funded by the employers and any unused cash belongs to the company. With the HSA, employees make contributions with pretax dollars—and employers may or may not match them—and unused cash belongs to the employee. Because more of the financial burden is on the employee, consultants say more companies will choose HSAs.

With either account, employees can expect to pay deductibles of at least $1,000 for individuals and $2,000 for families. HSA participant may fund an account well beyond t deductible with pretax contributions to $2,650 for individuals and $5,250 families. (There's no limit on HRA c tributions.) Both plans cover 100% o medical expenses once the deduct has been reached. And both usually 100% of preventive-care costs that d count toward the deductible. There no co-payments.

Viewed as investments, HSAs are si lar to a 401(k)—the participants cho among an array of investment opti The account's earnings are not taxe whatever isn't used is rolled over to the lowing year.

HRAs and HSAs should appeal to y you are generally healthy and don't up many bills. (The average per spends less than $700 for health care

ally, according to David Stacey, senior nsultant at Hewitt Associates in Lin- nshire, Ill.) That's why Ron Sussman, esident of CPI Cos., a financial-services n in Voorhees, N.J., plans to add an A at his 13-employee company. "The ount of money we are paying for alth insurance is ridiculous, and it ves me nuts because we are not using benefits," says Sussman, 47.

HSAs also are a good tool for self-em- yed workers who need tax shelters. ou not only get to write off premiums, you get to make tax-deductible de- sits into your HSA," says Steve Sharkey, a brokerage representative at John Alden, a unit of Assurant, in Philadelphia.

Before you sign up, pay attention to fees. Some plans charge up to $50 per year in administrative fees, although larger plans may drop those costs. In addition, look at the underlying investment options to make sure they'll help you meet your savings goals.

CO-PAYS AND DEDUCTIBLES

THOSE $15 or $20 co-payments you shell out for your point-of-service or preferred provider organization plan every time you visit the doctor may disappear for some plan participants. Instead, you'll be required to pay an up-front deductible of about $300. After you meet that deductible, expect your insurer to pay 90% of any costs if your doctor is within the plan's network. (Insurance often pays only 70% if it's out of network.)

PRESCRIPTION DRUGS

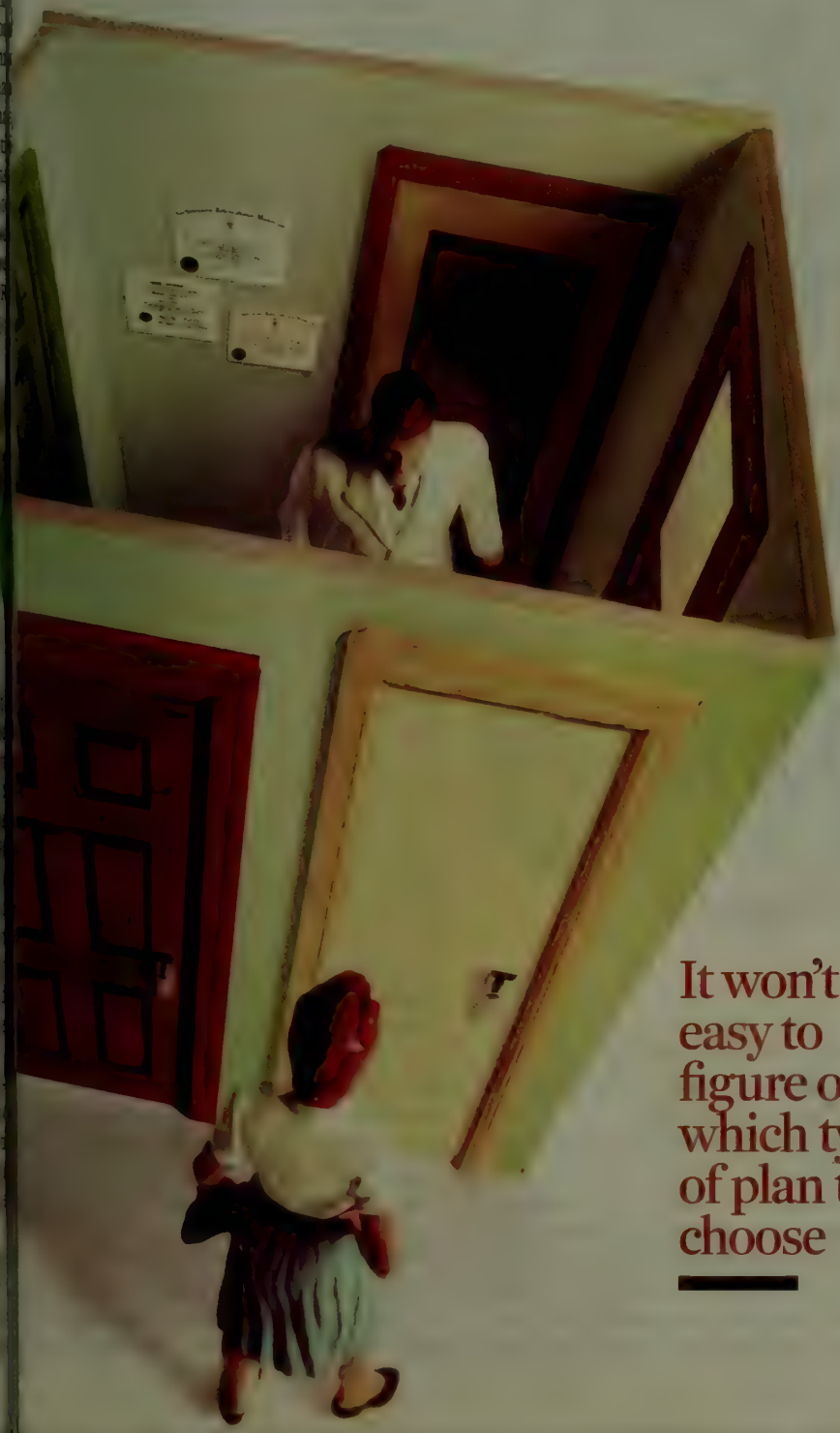
CO-PAYMENTS FOR brand-name drugs (typically $20 to $30 each time you fill a prescription) will be about $5 higher in 2006, although generic-drug co-payments ($10 to $15) should be about the same, consultants say. Pharmacy-benefit managers say that fewer than 20% of all employees currently take advantage of mail-order drug plans, but if you use one, you can save as much as half on any medications you take on a continuing basis. Plus, it's convenient. "It's a heck of a lot easier to have the stuff arrive in your mailbox every 30 days," says Tom Billet, a senior consultant at benefits firm Watson Wyatt in Stamford, Conn.

If you don't go for online purchases, your plan might force you. More employers are implementing mandatory 90-day mail-order programs for maintenance drugs such as Lipitor, a cholesterol-fighting drug, to cut costs. If you take a drug on an ongoing basis, your only option may be to buy three months' worth through the mail. "You can't keep going back to your pharmacy and buying it over and over," Billet explains.

WELLNESS SURVEYS

MORE COMPANIES ARE asking their employees to fill out online health assessments with financial incentives. At Xerox, for instance, employees who participate in an online health appraisal earn $200 in health-care discounts. "After answering questions on stress, their weight, cholesterol, and other health topics, employees who are deemed to be high-risk in three areas are eligible to work with a free health coach," says Kara Choquette, a Xerox spokeswoman.

At international pharmaceutical giant AstraZeneca, employees save $50 a month if they take part in a new online health survey—a quick $600 off their annual health-care bill. "In the first 10 days, we already had over 50% of employees participate in the assessment," says Carla Burigatto, an AstraZeneca spokeswoman. With health-care benefit costs continuing to move in just one direction, who wouldn't jump at any opportunity to save? ■



It won't be easy to figure out which type of plan to choose

STEPHEN WEBSTER

Your Guide to The Medical Maze

Advocates can help with research, cutting red tape, and making decisions. **BY ANNE TERGESEN**

ABOUT A YEAR AGO, ANN Principe saw worrisome symptoms in her 75-year-old mother. "Her short-term memory was gone. She was forgetting her own granddaughter's name," the 47-year-old Kensington, (Md.) woman recalls. Principe sought help. Instead of calling one of her mother's half-dozen doctors, she phoned the family's health advocate—a new breed of adviser who guide patients through the medical maze.

The advocate, who works for Baltimore-based Pinnacle Care International, gathered medical records and consulted with each of the woman's doctors. The recommendation: Cut back on some of the medications, the combination of which could be causing memory problems. Now, says Principe, her mother is "fully aware of what's going on and feels well."

The health advocate is just the latest sort of personal adviser the busy professional can enlist. In a time of serious illness, these advocates can help research new treatments that doctors may not know a lot about, cut through the medical bureaucracy, and perhaps help frame medical decisions more objectively than stressed out patients and their family members. Advocates aren't just there to help you heal but also to keep you healthy. Richard Rossi, 50, co-founder of Vienna (Va.)-based Envision EMI, a developer of educational programs, recently plunked down $10,000, plus a $5,000 annual retainer, to sign on with Pinnacle. "For a healthy person like me, it's all about optimizing health," he says.

As a private, for-profit provider, Pinnacle is at a fast-growing end of the health advocacy business. There are other sources of help. Various nonprofits offer similar advice for free. So do some hospitals, clinics and insurers, though some advisers work for those institutions so their advice may not necessarily be objective.

By hiring your own advocate, you're banking on getting highly attentive service. Just be aware that this is an unregulated industry. As a result, there's a lack of uniformity in advocates' services, credentials, and fees. Advocates may have medical backgrounds, hail from the insurance industry, have social work degrees, or be former patients who have learned from their own experiences. While some focus on resolving insurance disputes, others aim to facilitate medical decision-making. Some specialize in managing care for particular diseases, such as cancer. The high-end providers even throw in concierge-type amenities: For example, Pinnacle advocates will call to remind clients to take their medication, even several times a day.

If you're interested in retaining an advocate, seek referrals from doctors, other patients, and the nonprofits that specialize in the disease or medical condition you're trying to treat (table, page 122). Ask what services you'll receive, fees you'll pay, and whether your advocate receives money from doctors, hospitals, or other sources that could compromise objectivity, says Marsha Hurst, director of the health-care advocacy master's degree program at Sarah Lawrence College in Bronxville, N.Y. If you're in the market for a health advocate, here are the types of services available:

COMPREHENSIVE ADVOCACY

AMONG ADVOCATES offering a wide range of services, Pinnacle, founded in 2002, offers perhaps the most personal-

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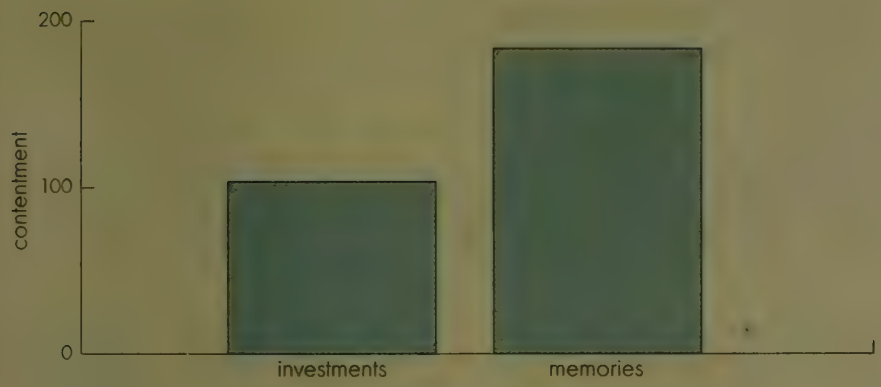
CONTENTMENT INDEX

relative to investments



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ized—and expensive—care. Clients, along with spouses and children under age 23, are assigned an advocate who is typically a nurse or social worker, although about 10% are doctors.

To expedite diagnoses, Pinnacle can arrange back-to-back appointments with specialists. Advocates research doctors' credentials and success rates. They also investigate clinical trials and help clients select treatments. To get patients to the front of the line with booked-up specialists, advocates ask the 51 unpaid doctors on Pinnacle's medical advisory board to pull strings at renowned centers such as Johns Hopkins and The Cleveland Clinic. Advocates attend examinations to take notes and ask informed questions. The company locates nutritionists, experts in alternative medicine, and cosmetic surgeons.

Some advocates pull strings with renowned specialists

Pinnacle charges a one-time initiation fee of $10,000 to $30,000 per family, which covers costs that include gathering medical records and a detailed two to five hour consultation. Clients also pay an annual retainer of $5,000 to $25,000. (Where a client lands on the spectrum of fees depends on the level of service selected.) While the fees include a comprehensive "executive" physical for one family member, clients or their insurers are responsible for all other medical bills. By assuming much of the burden for paperwork and medical research, Pinnacle aims to help the busy executives it caters to stay focused on business.

There are less costly alternatives. The nonprofit Center for Patient Partnerships at the University of Wisconsin Law School serves people with chronic or life-threatening illnesses for free. The center can help resolve insurance disputes and negotiate lower medical fees. Advocates also look into treatments and help finagle appointments with specialists, says Meg Gaines, who founded the center in 2001.

Some other comprehensive services contract with employers, who provide advocacy as a perk for employees. At least one, Health Advocate of Plymou Meeting, Pa., also works for individu for $125 an hour. "We're not promoti this, but we try to avoid turning som one away," says executive vice-preside Martin Rosen.

INSURANCE ADVOCACY

SOME ADVOCATES FOCUS on assisti with insurance-related matters. O such organization is the nonprofit P tient Advocate Foundation of Newpo News, Va., which also helps resol financial problems precipitated by i ness. Its services are free, but you've g to have a chronic or life-threatening i ness to qualify. Alternatives inclu Healthcare Navigation, a Fairfie (Conn.) firm that charges from $80 $200 an hour.

MEDICAL ADVOCACY

SOME PATIENTS MAY WANT advocate who specializes in a particul area of medicine. Dr. Gail Gazelle, assistant clinical professor at Harva Medical School, works mostly for tho with chronic or incurable diseases her Boston practice, Palliative Ca Associates. Meanwhile, a majority clients of HKS Patient Advocates New York are battli cancer.

Be aware that adv cates with a medi specialty may not p vide much help with i surance paperwo Still, they often do mo than facilitate medi decisions. Gazelle, w charges $200 an ho says she's often called when patients " getting close to the e and have a lot of que tions." She gives clie her cell-phone numb and gently sugge strategies to help far lies cope.

When sickne strikes, it's helpful have someone in yo corner to help you ma informed decisions. L Ann Principe, you m discover an overlook solution to a medi problem. At the v least, you'll be able spend more time wh it counts—getting w or helping the patient

Picking the **Right** Advocate

No two health advocacy practices are exactly alike. Before signing on, make sure you understand the fees you'll pay and the services you'll receive. Here are some of a growing number of resources that can help:

NAME & CONTACT INFORMATION	COST	DESCRIPTION
CENTER FOR PATIENT PARTNERSHIPS 608 265-6267 www.law.wisc.edu/patientadvocacy	None	Serves patients with chronic or life-threatening illnesses
HEALTH ADVOCATE 866 695-8622 www.healthadvocate.com	$125/hour	Researches care, expedites appointments, tackles insurance paperwork and disputes
HEALTHCARE NAVIGATION 203 333-2244; healthcarenavigation.com)	$80 to $200/ hour	Helps with medical bills and insurance issues
HKS PATIENT ADVOCATES 212 725-5800; HKSPatientAdvocates.com	$225/hour or $4,000/year*	Specializes in medical decision-making
PALLIATIVE CARE ASSOCIATES 617 522-5210; pal-care.com	$200/hour	Dr. Gail Gazelle works with patients with chronic and incurable diseases
PARKINSON'S DISEASE FOUNDATION 800 457-6676; pdf.org	None	Hotline answers questions about treatments and research, with referrals to neurologists
PATIENT ADVOCATE FOUNDATION 800 532-5274; patientadvocate.org	None	Helps patients with chronic or life-threatening illnesses resolve insurance problems
PINNACLE CARE 866 752-1712; pinnaclecare.com	$5000 to $25,000/year**	Concierge-type conveniences, plus medical advice and insurance help

*$[illegible] consultation fee **Plus a one-time initiation fee of $10 000 to $30 000 per family **Data:** *BusinessWeek*

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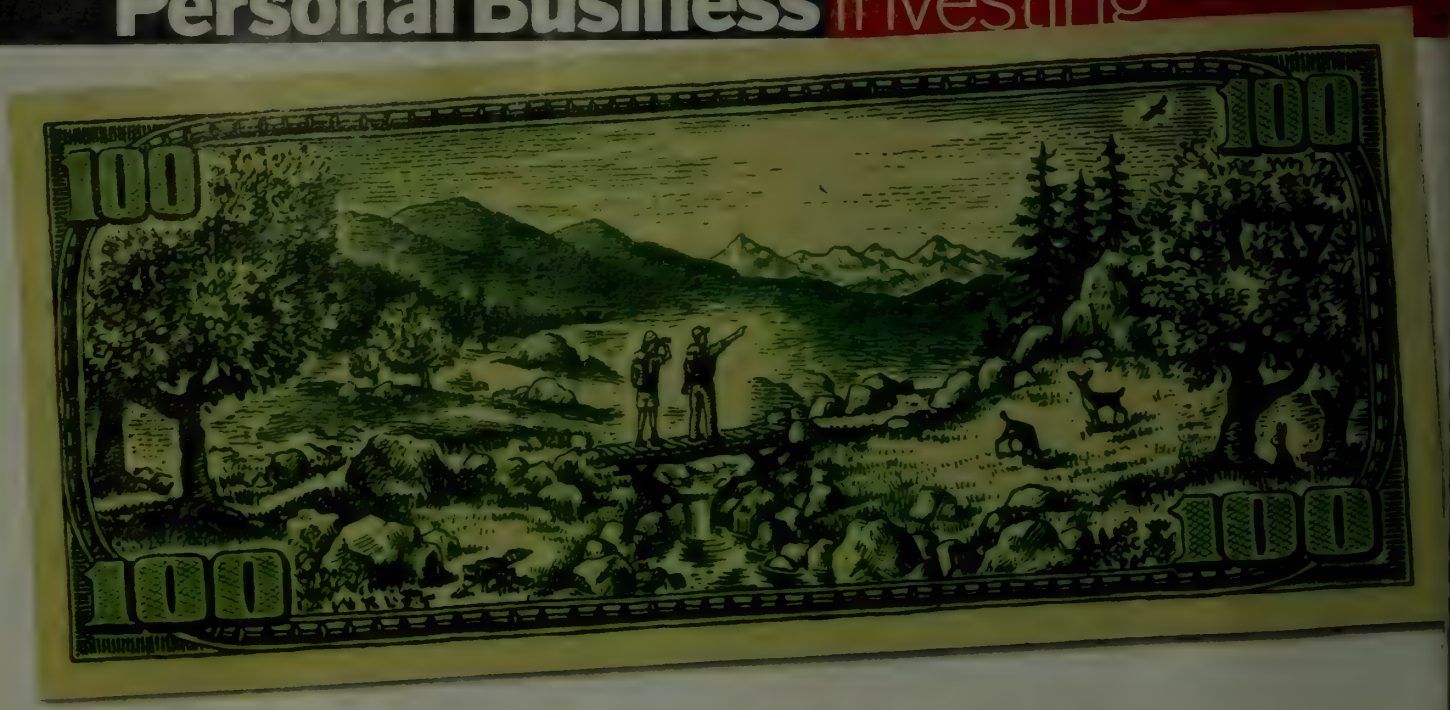

Activist Funds Make Waves

A new class of social investor doesn't believe in boycotting problem companies—it's opting to reform them from within. **BY AARON PRESSMAN**

SOCIALLY RESPONSIBLE INvestment managers are known for avoiding shares of companies that pollute the environment, deny health benefits to employees, or violate other ethical or environmental criteria. Yet Green Century Capital Management, which specializes in social investing, owns shares of ConocoPhilips and ExxonMobil. The Walden Social Equity Fund holds two oil companies, bp and Apache. And mma Praxis Core Stock, a fund that follows Mennonite teachings, holds Wal-Mart Stores shares.

These stocks may not meet the typical screening criteria used by socially responsible funds. But for these managers, being shareholders allows them to lobby management to make changes. That's better, they say, than simply avoiding undesirable businesses or whole industries. "Our interest is not just in keeping our hands clean but [also] in making the world a better place," says Mark Regier, who oversees shareholder activism at mma in Goshen, Ind.

Socially responsible funds are just a blip on the mutual fund radar, but they have a robust growth rate. Some 200 funds boasts assets of $37.4 billion, up 21% from a year ago, according to Lipper. The sort that invest in once-taboo companies make up just a small part of the social investing sector.

Investors don't necessarily surrender anything in performance to pursue nobler goals, but individual fund returns do vary (table). The Green Century Balanced Fund has a 24% a year average annual return for the three years ended Oct. 10, beating the Standard & Poor's 500-stock index by eight percentage points, according to Morningstar. Walden's fund, on the other hand, has been a laggard, with a 13% average annual return. By contrast, the Vanguard Calvert Social Index Fund—a more traditional fund that screens out offenders—is up an average 15% a year.

Managers of activist funds say sticking with problem companies allows investors to start a dialogue, bring resolutions before shareholders at annual meetings, and press management for improvements. MMA Praxis, for example, held on to Wal-Mart after the retailer was booted from the Domini 400 Social Index in 2001 over labor and human-rights conditions at some suppliers. "If you are concerned about the people who are hurt by Wal-Mart's policies, you will be doing absolutely nothing for them if you are not a shareholder," says Regier. Social funds, along with allies at pension funds and religi groups, filed almost 300 shareholder r olutions in the 2004-05 annual meet cycle, according to the Interfaith Cer on Corporate Responsibility.

A MORE COMPLEX PROCESS

THE PUSH TOWARD greater activisn happening as simple screening meth have come under increased critici Studies by Meir Statman, head of Sa Clara University's finance departm have found that social investing fur avoidance of certain companies had discernible impact on share prices. I year environmentalist Paul Hawken p lished a paper showing that screening teria were being applied inconsisten Tobacco giant Altria and oil services defense contractor Halliburton were h in some funds. "The term 'socially sponsible investing' is so broad [that] meaningless," wrote Hawken. Ea this year the socially responsible fund tracted unfavorable attention when t grappled with how to treat Starbucks. World Funds, with $2 billion in as dropped the coffee chain after it pu name on an alcoholic beverage, e though the company is widely consid to be a paragon of good workplace environmental values.

aking on corporate managers ough shareholder resolutions is a wer and more complex process than ply screening out offenders, but this thod has a growing track record of ac- plishments. One by one, almost all major oil companies have dropped of a lobbying group seeking drilling ts in Alaska following shareholder ssure. Nike, Gap, and TJX have eed to investigate and report on con- ons at the factories of their overseas pliers. And Wal-Mart created a unit h 200 employees that last year over- audits of some 7,600 factories, ac- ding to the company.

he TJX example illustrates, however, t the activist strategy can take time to w results. Timothy Smith, Walden's ector of socially responsive invest- nt, says he and other investors first ed the issue of overseas working con- ons at TJX suppliers five years ago. Ini- ly the company wasn't responsive. In t, that was because only a small por- of sales came from its house-brand els. At the company's 2002 annual eting, Walden's resolution asking for a ort on vendor working conditions nered the support of just 5% of shareholders. The next year a resolution on vendor standards got 8% of the vote, then 10%. Last year the company hired an outside expert to investigate. "It's a work in progress," says Smith.

The Mennonite funds have also been active trying to raise coffee bean prices for individual farmers who produce a great deal of the world's coffee crop. Big coffee buyers such as Procter & Gamble have long relied on huge commercial outfits that paid the growers little. In a November, 2002 letter, MMA and others sought to persuade P&G to buy directly from small farmers. Less than a year later the company agreed to buy "fair trade" beans—the term for coffee sold by farmers' nonprofit cooperatives—for its specialty Millstone label.

Green Century, a money-management firm started by environmental advocacy groups, takes an unusual approach to qualify as a shareholder for some of the companies it deems harmful to the earth. Instead of holding shares of ExxonMobil or Chevron in its mutual funds, the management company itself buys shares. That way, the funds don't own them, but the socially responsible point of view can be heard. Says Green Century President Amy Perry: "We exist to change corporate environmental behavior." ■

Social Funds that Break the Mold

FUND (SYMBOL)	TOTAL RETURN* 2005	TOTAL RETURN* 3-YR.	EXPENSE RATIO	ASSETS (MILLIONS)	MINIMUM INVESTMENT
Green Century Balanced (GCBLX)	0.69%	23.87%	2.37%	$60	$2,000
MMA Praxis Core Stock (MMPAX)	-2.60	9.75	1.33	310	500
Portfolio 21 (PORTX)	0.12	21.10	1.50	90	5,000
Walden Social Equity (WSEFX)	-4.78	12.75	1.00	45	100,000

*Appreciation plus reinvestment of dividends and capital gains before taxes. For periods ending Oct. 10, 2005. Three-year returns are average annual.

Data: Morningstar Inc

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Less Dashing to Find the Cell Phone

New cordless gear lets you pick up your mobile from any set in the house. **BY LARRY ARMSTRONG**

RCA The $120 system includes a place to dock your cell

I HAVE BEEN INTRIGUED FOR A couple of years now by gadgets that can make your cell phone and home phone work better together. They let you use any phone in your house to make and receive cell calls. That means you can use regular cordless (or corded) handsets to take advantage of free long-distance minutes on your cell plan. You can get several family members on extensions to share the weekly call to the grandparents. And you can answer cell calls in dead zones, places in your house where the signal doesn't reach.

Now three companies—Motorola, RCA, and Uniden—have come out with cordless phone systems that almost seamlessly integrate home and cell phones. They're a huge improvement over the adapters sold by a couple of small companies, which let you hook up your cell to a single conventional phone.

You can see how these new units work just by looking at the handsets. The simplest have buttons that say "land" and "mobile," or "home" and "cell." Pick up the handset, choose the line you want to use, and make your call. You also can program the systems to use different ringtones so you know whether you're getting a call on your land line or cell phone.

I used all three for a couple of weeks and liked the RCA 23200 and Motorola SD4500 Series models the best. Their setups are similar. Each comes with a base station, which includes a cordless handset, and a separate docking station for your cell phone. You plug the base into a phone jack and an electric outlet. The docking station, which also recharges your phone, requires only an electrical outlet. The idea is that you can put it someplace else in your house—either a convenient location, such as where you usually recharge your cell, or in the spot that gets the clearest ce lar reception.

The RCA system sells for $120 to $1 and extra handsets run about $50 api (The system can handle up to two mo Each component of Motorola's is s separately so that you can piece toget the system you need. The cell dock r $72 to $98, depending on where you it. There's a simple handset and base tion ($52 to $66) like RCA's, and oth that include answering machines ($5 $90). You can add up to seven e handsets for $40 to $50 each. The also a video camera, which I didn't tes case you want to use the system to mo tor a baby's room, for example.

Uniden took a more ambitious proach, and it doesn't work as well around $250, it's the most expensiv the three systems. Instead of a dock

UNIDEN It costs $250—and uses a Bluetooth radio link

BusinessWeek weekend

To see how these cell phone docking static work, watch *BusinessWeek Weekend*. Ple check your local TV listings or go to businessweekweekend.com to view this a other stories from our weekly TV program

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ion, your cell and the lless phones are nected by a Bluetooth o link. I had trouble ing the connection to k on a Nokia 6682, a nd-new Bluetooth ne: The Uniden's flip-n handset would con- to the cell phone and the number, but I dn't talk over it or hear person I had called. It ked fine, however, with okia 7610 phone.

fter I got it working, I overed that the Uniden lless phone didn't have range of the RCA and orola systems. It would drop the call if I got too way. That's not a Bluetooth problem; cordless phone just isn't as good.

MOTOROLA The base and docking stations with phones

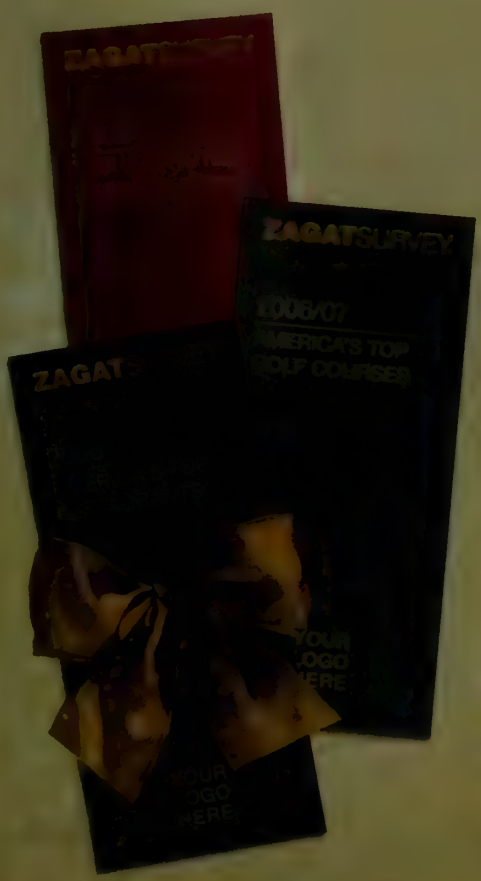
JE BLUETOOTH

OU REALLY WANT a Bluetooth con-ion between your cell and home nes, check out the Dock-N-Talk ($210 the Bluetooth module) at nelabs.com. It doesn't come with a cordless phone, but if you already have one, you can plug it in and make cell calls using that phone. To get it to work much the same way as the new phone systems—with both cell and land-line service—you'll need to get a cordless phone system that's designed to handle two separate land lines.

None of the systems work with all cell phones. Because Bluetooth units bypass the proprietary hardware connections that cell-phone makers use, they theoretically will work with the most. Uniden says it has tested the phone with 36 models, and Dock-N-Talk works with more than 600, though you'll have to buy a $20 adapter cable to use it with non-Bluetooth phones. RCA's comes with adapters for Motorola, Nokia, and Sony Ericsson phones and can handle about 60 models. Motorola's only works with Motorola phones, and not even all of those. (It couldn't accept my V220, for example.)

All three phones come with Caller ID and a memory for speed-dialing your calls. With extra handsets, two people can use the phones simultaneously, one on the land line and one on the cell. And you can use the Uniden and Motorola phones as an intercom within your home.

You don't even need a land line for these systems to work. If you have an old cell phone lying around, add it to your mobile service plan for an extra $10 per month or so, and drop it into a docking station. You'll get most of the advantages of both land and wireless—multiple extensions throughout the house and free long-distance calls and voice mail—without a monthly home phone bill. ■



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INVESTING

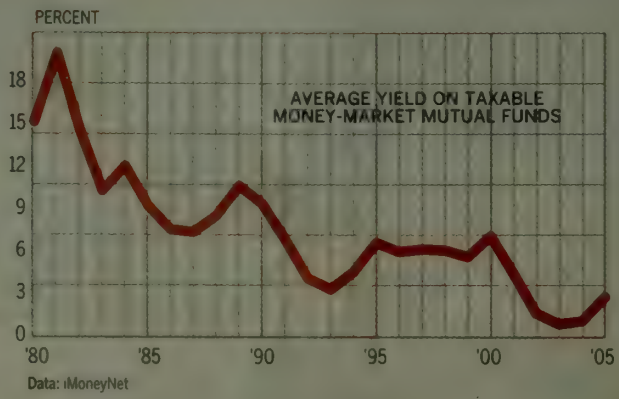
Watch Warren

WARREN BUFFETT HAS BEEN so successful picking stocks that he has attracted hordes of investors who seek to ape his every buy and sell order. The problem for followers, of course, is that federal disclosure rules allow the **Oracle of Omaha** to wait 45 days after the end of the quarter before revealing the contents of the Berkshire Hathaway portfolio—his investment vehicle—and even longer for specific stocks that are in the process of being accumulated or sold.

That should not prevent you from successfully following Buffett's moves. According to a yet unpublished research paper by **Ohio University** professor John Puthenpurackal and Gerald Martin, a visiting scholar at **Texas A&M University,** an investor who mimicked Buffett would have beaten the Standard & Poor's 500-stock index by an average of 11.6% a year from 1980 to 2003, even after accounting for the reporting lags. Buffett's picks tend to jump in price when disclosed, so the researchers didn't start measuring performance until two weeks after each filing. "Disciples can make money and beat the market," says Martin, who rates Buffett in the "100th percentile" of all investors. Puthenpurackal's and Martin's findings are to be presented on Oct. 15 at the **Financial Management Assn.** conference in Chicago. *—Aaron Pressman*

MUTUAL FUNDS

MONEY-MARKET MUTUAL FUNDS don't usually make for juicy cocktail party chatter, but, hey, how many investments do you know in which the annual return has more than tripled in three years? The average yield bottomed at 0.64% in 2002. Now, with the Fed pushing short rates higher, analysts at iMoneyNet think yields could hit 3.5% next year. That's rich compared with the recent past, but a far cry from the double-digit yields of the early 1980s.



THE WEB

A NEW DEFENSE AGAINST E-JUNK

DON'T YOU hate it when Web sites insist that you register before they will give you the information you want? Filling out those forms is time-consuming, an invasion of privacy, and often results in a torrent of spam e-mail. The anonymous developers of **bugmenot.com** will save you the hassle. All you have to do is go to their free site and enter the URL of the Web site you want access. Bugmenot.com will generate a user name and password created and donated by someone else for you to use. That way, you are granted entry without having to reveal your identity or create a fictitious one. *–Kate Murp*

SPIRITS

WASTE NOT, WANT NO

FIVE YEARS AGO, Kentucky's Heaven Hill Distilleries had to confront a small problem: about a quarter-silo's worth of winter wheat left over from distilling its Old Fitzgerald bourbon. How to use it up? "We do a 51% rye whiskey; why not a 51% wheat?" asked master distiller Craig Beam, grand-nephew of Jim Beam of bourbon fame. The result, Bernheim Original Kentucky Straight Wheat Whiskey, may usher in a new style. It has a sweet, vanilla taste, gentler than rye, with a hint of spiciness. The 90-proof whiskey, at $40 per 750-milliliter bottle, is just hitting stores, mainly in big cities and the Southeast. Better move quickly: The first year's supply is just 15,000 bottles. *–Gerry Khermou*

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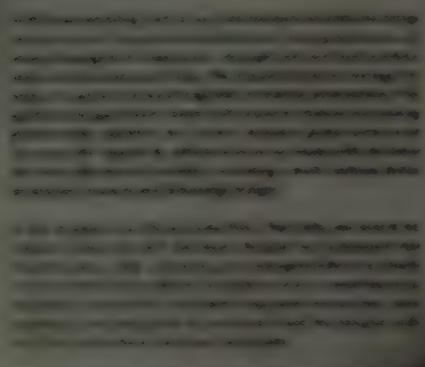

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BY GENE G. MARCIAL

REGIONAL BANK PNC'S RISK-REWARD PROFILE IS 'COMPELLING.'

AN ACTIVIST SHAREHOLDER TRIES TO LIGHT A FIRE UNDER IDT.

SETTLING A LAWSUIT MAY AID SHIRE'S ATTENTION-DEFICIT DRUG.

Rallying Cry for PNC

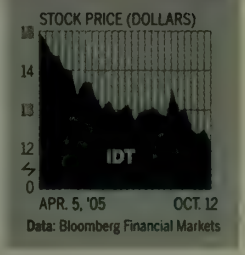
ANKING ANALYST DAVID GEORGE of A.G. Edwards is down on regional banks, in part because of rising interest rates. But he's high on PNC Financial Services ıp (PNC), whose risk-reward profile he finds ıpelling." With assets of $91 ın, PNC offers banking, mutual servicing, and asset management elaware, Kentucky, New Jersey, , and Pennsylvania. Its stock is up 49 a share in mid-April to 56 on 12. And more upside is ahead, icts George, who sees solid ings growth. Profits, which he says 't affected that much by interest-moves because of its other ıesses, will surprise the Street. He cts third-quarter earnings of $1.87 are—2¢ above the Street's consensus estimate. The ast for 2005 is $4.28; George expects $4.30. Next year, ojects $4.90—15¢ above what analysts expect. George the stock at 63 in a year, buttressed by a 3.5% dividend . Scott Siefers of Sandler O'Neill & Partners (it has done ing for PNC) says PNC's focus on fee businesses is ting earnings. A big part comes from 70%-owned stment outfit Blackrock, which manages $414 billion. One NC holder is famed investor Michael Price, formerly of klin Resources, who now heads MFP Investors.

MORE ROOM TO RUN?

T is Getting Wake-Up Call

HE WORLD'S LARGEST supplier of prepaid telephone calling cards, IDT (IDT), is a success story—except for its stock, which has fallen steadily since hitting 24 a e early in 2004. It's now at 12. Herbert Denton, president ovidence Capital, which owns shares, calls management riendly" to shareholders. True, shareholder equity is up $26.9 million on July 31, 1996, to $991 million on July 004. But he notes that the stock is now at its lowest price e past 40 months. Denton is urging the board to take n. He wants IDT to buy back a lot more shares, pay a lend, or even put itself up for sale. IDT has a cash hoard billion, or $9 a share. Denton puts its intrinsic value at ased on a sum-of-the-parts valuation. He points out that tutional Shareholder Services ranks it 2,964 out of 3,000 U.S. public companies in corporate governance. Seven of its 15-man board are IDT insiders. Andrew Baker of Cathay Financial says IDT should put its cash pile to better use to boost the stock. He rates it outperform. CEO James Courter says IDT's goals include raising its stock price and buying back shares. "Our clean balance sheet allows us to further improve our telecom operations and expand our entertainment business," he adds.

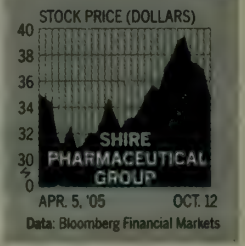
NOT MUCH OF A LIVE WIRE



Undivided Attention For an ADHD Battle

LATELY INVESTORS HAVE BEEN paying heed to once-ignored attention-deficit hyperactivity disorder, or ADHD. The reason: ADHD is now recognized as a major source of learning disability in kids, so sales of Adderall XR, the leading ADHD drug, are up. Shire Pharmaceuticals (SHPGY) sells Adderall, whose market is estimated at $750 million. Shire's stock rose from 30 in mid-May to 39 on Sept. 12. It is now at 35. But Barr Pharmaceuticals has sued Shire to invalidate its patent. Some pros expect an out-of-court settlement before the January, 2006, trial. Derek Taner of AIM Investments, which owns 2% of Shire, says Barr has a history of settling. If it does settle, it would jack up Shire's earnings, he says. Andrew Forman of WR Hambrecht figures a settlement will add 60¢ to his 2006 forecast of $1.90 and push up his 2007 estimate by 75¢ to more than $3. And, he adds, it would give Shire time to switch its patients to an upcoming ADHD drug developed by New River Pharmaceuticals, NRP104, which Shire will market. New River will seek regulatory approval later this year. Shire CEO Matthew Emmens says NRP104 will be a more effective drug with a much bigger market. He and a Barr spokeswoman declined comment on the lawsuit.

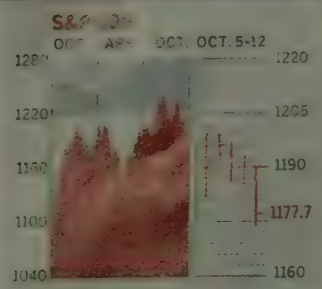
GROWING HYPERACTIVE



BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

STOCKS



COMMENTARY

Tech stocks rattled the market on Oct. 12, and fell to their lowest level since May. Hardest hit were Apple Computer, which reported disappointing revenues, and Intel, which analysts downgraded on worries about future results. The downdraft fueled investors' high anxiety about more Federal Reserve interest-rate hikes and persistently high energy costs.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	OCT. 12	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1177.7	-1.6	-2.8	5.0
Dow Jones Industrials	10,216.9	-1.0	-5.2	1.4
NASDAQ Composite	2037.5	-3.1	-6.3	5.8
S&P MidCap 400	675.0	-3.0	1.8	13.9
S&P SmallCap 600	327.1	-3.4	-0.5	11.7
DJ Wilshire 5000	11,724.1	-1.9	-1.9	6.9
SECTORS				
BusinessWeek 50*	714.0	-1.3	1.3	9.4
BW Info Tech 100**	354.4	-2.1	-5.0	6.5
S&P/BARRA Growth	566.4	-1.0	-2.7	5.1
S&P/BARRA Value	607.1	-2.1	-2.9	4.8
S&P Energy	371.1	-1.0	28.6	31.8
S&P Financials	384.4	-1.4	-6.5	-1.1
S&P REIT	141.0	-4.7	-2.4	7.7
S&P Transportation	219.0	1.0	-9.3	2.7
S&P Utilities	158.3	-3.7	11.8	21.7
GSTI Internet	172.3	-1.9	-3.4	13.8
PSE Technology	774.8	-3.2	-0.6	13.6

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	OCT. 12	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1444.7	-0.6	1.4	
London (FT-SE 100)	5342.2	-1.6	11.0	
Paris (CAC 40)	4515.1	-1.7	18.3	
Frankfurt (DAX)	4981.8	-1.7	17.1	
Tokyo (NIKKEI 225)	13,463.7	-1.7	17.2	
Hong Kong (Hang Seng)	14,575.0	-3.9	2.4	
Toronto (S&P/TSX Composite)	10,493.1	-2.4	13.5	
Mexico City (IPC)	15,103.2	-3.9	16.9	

FUNDAMENTALS	OCT. 11	WEEK AGO	YEA
S&P 500 Dividend Yield	2.10%	2.05%	1.
S&P 500 P/E Ratio (Trailing 12 mos.)	18.3	18.9	19
S&P 500 P/E Ratio (Next 12 mos.)*	14.0	14.4	15
First Call Earnings Surprise*	10.81%	10.49%	2.

*First Call

TECHNICAL INDICATORS	OCT. 11	WEEK AGO	REA
S&P 500 200-day average	1199.8	1200.1	Nega
Stocks above 200-day average	47.0%	59.0%	Neu
Options: Put/call ratio	0.92	0.73	Posi
Insiders: Vickers NYSE Sell/buy ratio	4.12	4.33	Nega

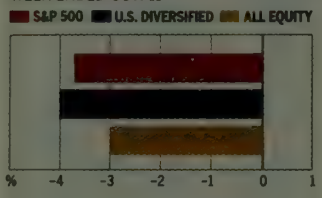
BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Divsfd. Metals & Mining	11.8	Oil & Gas Refining	100.5
Airlines	11.1	Managed Health Care	64.6
Gold Mining	10.6	Oil & Gas Exploration	58.8
Insurance Brokers	6.0	Fertilizers & Ag. Chems.	58.5
Railroads	5.9	Health-Care Distrbtrs.	52.4

WORST-PERFORMING GROUPS	LAST MONTH %		LA MON
Educational Services	-19.3	IT Consulting	-
Home Furnishings	-19.0	Automobiles	-3
Aluminum	-14.8	Aluminum	-
Specialized Cnsmr. Serv.	-12.2	Photographic Products	-3
Tires & Rubber	-11.6	Home Furnishings	-3

MUTUAL FUNDS

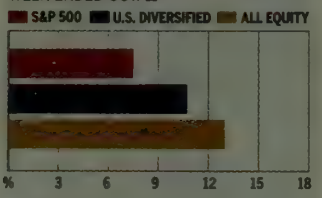
4-WEEK TOTAL RETURN

WEEK ENDED OCT. 11



52-WEEK TOTAL RETURN

WEEK ENDED OCT. 11



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Precious Metals	8.1	Latin America	66.2
Latin America	5.9	Natural Resources	40.6
Japan	3.8	Diversified Emerg. Mkts.	39.5
Diversified Pacific/Asia	2.8	Europe	26.5
LAGGARDS		**LAGGARDS**	
Real Estate	-5.7	Financial	4.6
Small-cap Growth	-5.3	Domestic Hybrid	6.8
Technology	-5.2	Large-cap Blend	7.8
Small-cap Value	-4.8	Large-cap Growth	8.9

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
ProFunds Precs. Mtls. Inv.	16.4	T. Rowe Price Emg. Europe	73.3
ProFds. USh. Sm. Cap Inv.	13.8	iShares S&P L. Am. 40 Idx.	72.1
Potomac Sm. Cap/Sh. Inv.	13.6	T. Rowe Price Lat. Am.	71.9
ProFunds Ultra Japan Inv.	10.8	Merrill Lynch Lat. Am. C	68.7
LAGGARDS		**LAGGARDS**	
American Heritage Grth.	-16.7	Ameritor Investment	-58.3
ProFunds. Semicdr. Inv.	-12.9	American Heritage Grth.	-28.6
ProFds. Mble. Tlcmms. Inv.	-12.4	ProFds. USh. Mid Cap Inv.	-25.8
Alpine U.S. Rl. Est. Eq. Y	-11.4	ProFds. USh. Sm. Cap Inv.	-19.4

INTEREST RATES

KEY RATES	OCT. 12	WEEK AGO	YEAR
Money Market Funds	3.27%	3.25%	1.2
90-Day Treasury Bills	3.70	3.55	1.6
2-Year Treasury Notes	4.24	4.18	2.9
10-Year Treasury Notes	4.45	4.34	4.1
10-Year Treasury Bonds	4.56	4.57	4.6
30-Year Fixed Mortgage †	5.96	5.94	5.8

†BanxQuote, I

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.81%	4.
Taxable Equivalent	5.44	6.4
Issue of Revenue Bonds	3.95	4.
Taxable Equivalent	5.64	6.5

THE WEEK AHEAD

PRODUCER PRICE INDEX *Tuesday, Oct. 18, 8:30 a.m. EDT* » September producer prices are expected to have jumped 0.9% because of lofty energy prices. That's according to the median forecast of economists polled by Action Economics. In August higher oil prices lifted the index by 0.6%. Excluding food and energy, the index probably rose 0.2%, after holding steady in the previous period.

RESIDENTIAL CONSTRUCTION *Wednesday, Oct. 19, 8:30 a.m. EDT* » Housing starts during September most likely edged down to an annual rate of 2 million. The August pace of starts stood at 2.01 million.

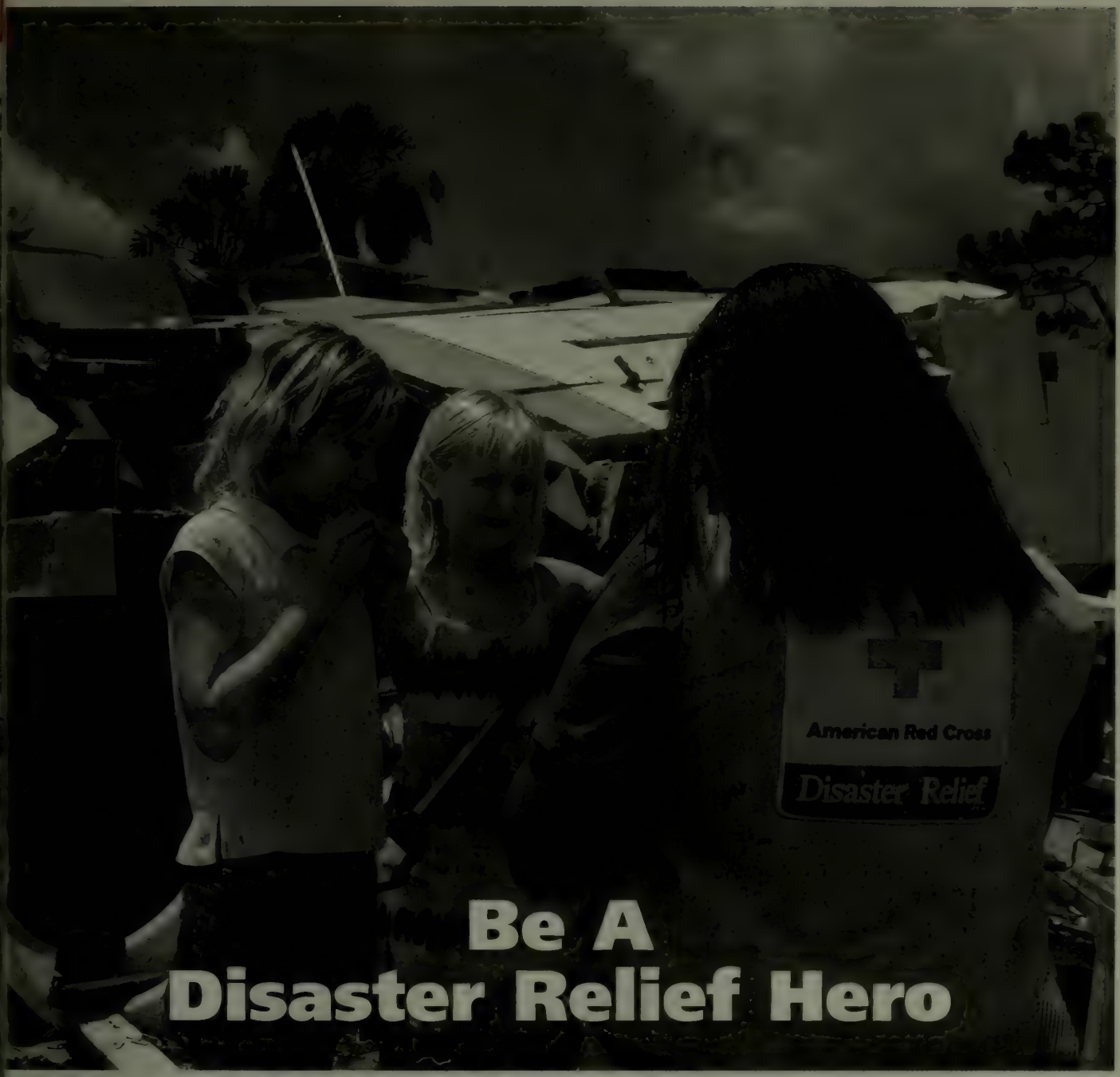
BEIGE BOOK *Wednesday, Oct. 19, 2 p.m. EDT* » The Federal Reserve releases its review of regional economic activity before the Nov. 1 monetary policy meeting. Every economist polled by Action Economics is forecasting another hike in interest rates, to 4%, up from 3.75%. In addition, most economists no longer believe the Fed will pause in December and expect rates to stand at 4.5% after the January policy meeting.

LEADING INDICATORS *Thursday, Oct. 20, 10 a.m. EDT* » The Conference Board's September index of leading economic indicators most likely fell 0.7%, after slipping 0.2% in August.

The *BusinessWeek* production in edged up to 257 for the week en Oct. 1 and stood 12.7% above previous-year level. Before calcu tion of the four-week moving av age, the index slid to 255.8.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/extras



Be A Disaster Relief Hero

Victims of the recent hurricane need help immediately. The **American Red Cross** is on the scene—providing shelter, food and counseling. But your help is urgently needed. Your contribution will help the victims of the recent hurricane and thousands of other disasters across the country each year.

Make a financial contribution to the Disaster Relief Fund.
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The New Risk Environment

Managing risk remains a challenging undertaking... the good news in a somewhat deeply disturbing risk environment: the problem is soluble. "In the long run," emphasizes the "Risk Landscape" report, "even complex risks can be understood well enough to be successfully handled."

The scene was chilling. With several days' warning, government officials were quick to urge residents of coastal Texas to evacuate prior to the arrival of then-Category 5 Hurricane Rita. And residents responded: with memories of Hurricane Katrina still fresh in their minds, they loaded up cars, vans, and buses and headed northward.

And then they waited.

Freeways north of Houston and other communities were so jammed with traffic that cars sat idle for hours. Many vehicles ran out of gas and were left stalled on the roadways, only worsening the congestion. As the hurricane neared landfall, tens of thousands of people remained stranded, many only miles from their homes.

One is prompted to ask: are we really prepared to handle a crisis on a catastrophic scale?

THE GROWING CONSEQUENCES OF RISK

The question is more than theoretical. According to a recent report entitled "The Risk Landscape of the Future," by global reinsurance provider Swiss Re, the risk environment is changing dramatically in ways that are just now beginning to penetrate the public's consciousness. "Since the 1970s," the group writes, "the number of serious natural catastrophes and technical disasters has increased.... The period from 1900 to 1928 showed an average of 1.7 disasters a year in the U.S. whereas between 1980 and 1989 there were 18. Over the past ten years, the number has risen to more than 38 events" per year.

Beyond their obvious and painful effect on communities and families, such events can have devastating consequences for businesses as well. Scores of companies, including some large and well-established firms, were virtually destroyed by the 9/11 terrorist attacks. The power failures in California two years earlier caused business productivity losses of $12.8 billion. More recently, the International Risk Management Institute estimates, as many as half of the businesses affected by Hurricane Katrina had no disaster

The New Environment

recover [illegible] most may never be [illegible]

In addition to natural disasters, corporations face a growing panoply of operational risks—serious challenges that have come to attend nearly every phase of day-to-day corporate operations. The accounting scandals that destroyed Enron, WorldCom, and Arthur Andersen produced a tougher compliance regime that now costs the average public company some $5 million to $7 million a year. The cost of Internet interruptions in terms of lost business transactions, the Insurance Information Institute estimates, can easily reach into the millions. Computer viruses alone cause more than $13 billion in damage a year, according to the American International Group's eBusiness Risk Solutions. The tort liability price tag for small businesses in America is quickly approaching $100 billion a year. And the list goes on.

These risks can multiply as companies move overseas, notes Atradius, Inc., a global leader in credit insurance. Insolvencies, protracted defaults, and other creditor problems that are difficult to handle within a single country can become virtually impossible to resolve in a timely fashion across borders. With international trade becoming a more central part of most companies' operations, payment problems with a single large foreign creditor can be potentially devastating for companies without credit insurance.

THE INTERNATIONAL RISK MANAGEMENT INSTITUTE ESTIMATES AS MANY AS HALF OF THE BUSINESSES AFFECTED BY HURRICANE KATRINA HAD NO DISASTER RECOVERY PLAN, AND MOST MAY NEVER BE REOPENED.

THE EXPECTED VALUE OF RISK

This exponential increase in the consequences of risk requires that corporations begin thinking about risk in a dramatically new ways. Previously, notes the Swiss Re report, corporations typically worked to reduce the probability that the most commonplace risks would take place. Hence, fire-prevention measures, industrial safety precautions, product quality control procedures, and investment safeguards were at the top of most risk managers' agendas. Less likely risks received considerably less attention because their probability of occurrence was so low.

As the consequences of potential risks increase, however, the probability of a given risk's occurrence cannot be the only concern. Economists use a measure called "expected value" to assess risk. Expected value is simply the predicted cost associated with a risk weighted by its likelihood of occurring. A $10 million catastrophe with a 1% chance of occurring, for instance, has an expected value of $100,000. One key implication of this calculation is that, as the predicted costs increase, the expected value can skyrocket, even if the risk's probability remains low. To continue the example, if the predicted cost of a risk rises to $10 billion, even an extremely low probability of 0.01% yields an expected value of $1 million.

To be sure, corporate risks that have very high expected costs but that are unlikely to occur within any given time period require a much more careful balancing of costs and benefits than more commonplace but less costly per-incident risks like shop floor accidents. They also require assessments that encompass the entire enterprise. In the past, the cost of a defective product may have been nothing more than the replacement fee. Now, when defective products can lead to multi-billion-dollar class-action lawsuits and scathing media coverage, a company's very existence can be imperiled. Suddenly, every corporate department becomes a vital player in the risk assessment and prevention process.

ENTERPRISE RISK MANAGEMENT

In response to the spreading ramifications of risk, a growing number of corporations are adopting a strategy called "enterprise risk management" or ERM, to improve their risk management capabilities. A recent survey of 271 risk management executives by the Conference Board and Mercer Oliver Wyman discovered that, while only 1[illegible] of firms had completed their ERM implementation, fully 90% were either building or intending to build such processes into their organizations.

Enterprise Risk Management is exactly what it appears to be: an enterprise-wide method of gauging, preparing for, and responding to risk. ERM requires an entirely new way of thinking about risk, and is not without its own challenges (see box). But it also may offer corporate leaders their best hope of managing the widening array of ever-more dangerous risks.

Assessing and implementing risk management strategies like ERM that are designed to deal with unlikely but high-expected-value risks starts with adequate knowledge. Recognizing this need, XL Insurance, a leading international insurance firm, has created a database called LossLink that documents the known costs of a wide variety of potential disasters and other insurable incidents that help corporate risk managers improve their risk calculations. Beyond requiring baseline facts like these, risk managers also need to be able to translate what can be vast arrays of information into actionable intelligence. Indeed, notes Jerry Miccolis, a former principal with Tillinghast-Towers Perrin, one major reason that many corporate managers have been frustrated with their progress on risk management is the lack of adequate risk modeling tools. But newer, causally based models offer substantial improvements over previous statistically based models.

Once the knowledge and tools have been developed, they need to be accompanied by commitment. And almost always, that commitment must come

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-200568

The New RISK Environment

from the top. David Nicastro of Sure Source, Inc., an international risk consulting firm, argues that "senior management needs to embrace the notion that it's worth investing time and money into the processes, procedures, and materials needed to protect employees, proprietary assets, and the communities they serve."

Finally, there must be a method in place that adequately identifies, evaluates, and protects against the impending consequences of high-expected-value corporate risks across the enterprise. In the past, many corporate risk management programs operated in rigid silos—industrial risk management was the responsibility of the facilities manager, investment risk the responsibility of the chief financial officer, and so on. With the increasingly enterprise-wide nature of risks in general and solutions like ERM in particular, risks need to be viewed on a broader scale, free of political or departmental barriers, if they are to be adequately contained.

INTELLIGENTLY MANAGING RISK

Managing risk remains a challenging undertaking, not only because the nature of the risk environment has changed dramatically, but because the future—the province of risk management—is inherently unknowable. But tools like Enterprise Risk Management, especially when accompanied by adequate knowledge and tools and high-level corporate commitment, now make it possible to understand and prepare for risk much better than ever before. And that's the good news in a sometimes deeply disturbing risk environment: the problem is soluble. "In the long run," emphasizes the "Risk Landscape" report, "even complex risks can be understood well enough to be successfully handled."

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* PLANNING TO MANAGE RISK *

Developing an effective Enterprise Risk Management (ERM) program is a necessary but often challenging task in the new risk environment. As Mark Carey, CEO of DelCreo, Inc., a leading ERM consulting firm, points out, "Many risk managers lack formal training and experience in several areas that are critical to a successful risk management program, including strategic and business planning. As a result, many risk managers find it difficult obtaining necessary management buy in, time, and attention."

Fortunately, these problems usually can be remedied through a carefully thought-out ERM development plan. Carey, who serves as the ERM Expert Commentator for the International Risk Management Institute, suggests four key steps that not only will help secure adequate management attention and funding for an ERM initiative, but lead as well to an effective implementation once the program is launched:

- **Define objectives.** *Demonstrate that the ERM program recognizes and takes into account the company's ongoing corporate objectives, and define the program's role in ensuring that the company can continue to fulfill these objectives both during and after a crisis.*
- **Demonstrate value.** *Clearly document both the costs of the ERM program and its likely benefits for a range of potential risk scenarios. Specify how these costs and benefits will be measured, and then demonstrate for each of the scenarios how the ERM program yields significant value to the company by preserving its ability to fulfill ong ing corporate objectives.*
- **Focus the program.** *Even the most effective ERM programs cannot achieve everything. This is particula true during a crisis, when normal procedures and communication channels may be impaired. Therefor beginning in the planning stages, carefully focus the ERM program on few well-defined goals, such as: (1) which specific risks the program will manage; (2) which risk managemen processes, technologies, and investme will be required; and (3) how these efforts will be coordinated across the enterprise. Once this focus is defined, clearly communicate it to a program stakeholders.*
- **Be thorough.** *Your program should cover all of the aspects of strategic pla ning that are vital to the program's success, such as a clear assessment of t company's current risk management efforts, the potential risks and associa costs the company is likely to encount during a crisis, the road map for imp menting the ERM program, the speci resources required, the performance measurement mechanisms to be used, and the benefits that will accrue to t company and the stakeholders when program is in place.*

Carey emphasizes that a comprehens ERM program, of course, involves oth factors than these. However, he notes that risk managers who get these fun damentals right from the outset "tend to be more successful in implementin an effective ERM program."

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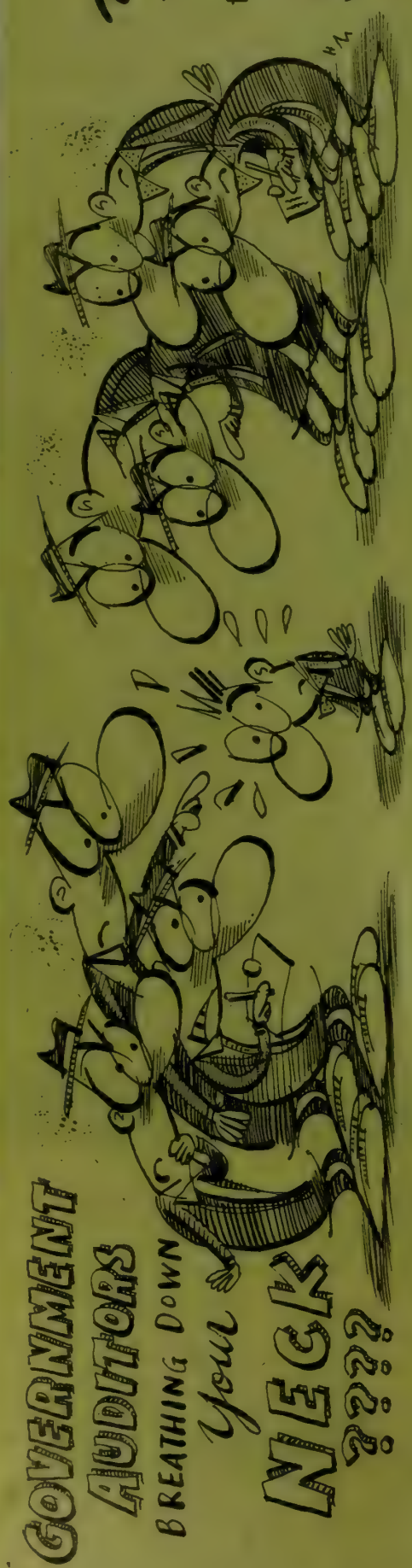

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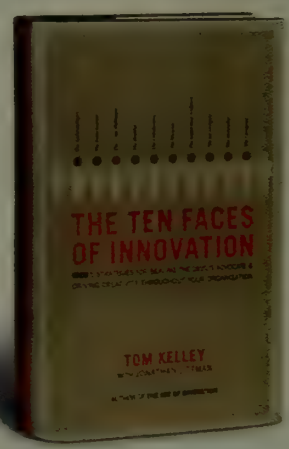
Innovation as a Team Sport

THE TEN FACES OF INNOVATION IDEO's Strategies for Beating the Devil's Advocate & Driving Creativity Throughout Your Organization
By Tom Kelley with Jonathan Littman; Currency/Doubleday; 276pp; $29.95

Like many people these days, I only have time for books during airplane trips. And I measure how long they take to read by mileage. Tom Kelley's *The Ten Faces of Innovation* is a coast-to-coast, five-hour affair. But unlike the mostly unsavory food served on transcontinental flights, this book delivers some tasty morsels to managers hungry to boost their companies' level of innovation. It is funny, insightful, and chock-full of surprising examples. If you take it on a flight from Los Angeles, you will have something to use at work by the time you land in New York.

Kelley begins by breaking down the process of innovation and debunking the notion that it is somehow magical and the stuff of individual genius. "Innovation is a team sport," he says, then proceeds to lay out the 10 personas, or types of people, who bring their talents to a winning team. There's the Anthropologist, who goes into the field to observe how people interact physically and emotionally with products, services, and spaces. The Experimenter is the team member who transforms new ideas into working prototypes, taking calculated risks on something different. The Collaborator has the skills to lead multidisciplinary teams and win over skeptical "buyers" within the corporation. One of my favorites is the Experience Architect, who designs compelling experiences that go way beyond functionality to connect with consumers emotionally, as in the cases of Starbucks Corp. cafés and Apple Computer Inc. iPods. Each player is important to innovation, but the only way to raise your company's overall score is to build a great team.



My favorite section is Kelley's examination of brainstorming. To generate new thinking, companies expend huge amounts of time in meetings—much of it wasted. Meetings tend to be too big, last too long, start with banal pep talks, and take place in the dullest of rooms. And there's almost always a joker who wants to undermine every new idea. Kelley takes direct aim at the devil's advocate, which he regards as the enemy of innovation, and offers advice on how to counter negativity. This is important: Brainstorming is vital, and most companies are new to it.

Kelley also talks about how companies can build their own innovation labs. The hot new thing, these are places set aside to let people focus on new projects and encourage creativity and new-design strategies throughout an organization. Procter & Gamble calls its lab "The Gym," Mattel had "Platypus," and Eastman Kodak, Steelcase, and many others have such centers. Kelley's advice? Keep labs small, with room for 15 to 20 people max, and physically separated from where daily work goes on. There should be lots of props to provoke conversation and ample wall space for sketch boards and visuals. Meetings there should shoot for a large number of possible ideas. Are Kelley's tips obvious? Perhaps. Yet it is amazing how many managers don't know how to shape a gathering that generates ideas. A good hour-long session can come up with 100, and often the wackiest turns out to be the best. DVDs by mail? A mop that doesn't use water? An Apple retail store?

Kelley's book is also a trove of pointed stories. One, offered by Henry Ford, concerns the danger of listening too closely to customers. "If I had asked my customers what they wanted," Ford said, "they would have said a faster horse." Customers don't envision the future, they inform the present. Another tale concerns the 1921 birth of masking tape. It involves one Charles Richard Drew, a banjo-playing college dropout and lowly lab technician for 3M, which was then an unprepossessing maker of sandpaper. While delivering sandpaper to an auto-body shop, Drew observed a worker struggling with glue and butcher paper as he attempted a two-tone paint job. Eureka! Drew envisioned masking tape. Unfortunately, 3M would have none of it. But, working in secret, Drew found a way to make the tape. The lesson? Observation and imagination—plus insubordination—can be great for innovation.

For all that it delivers, Kelley's book has one severe limitation: The author's insights are all filtered through a single design consultant, IDEO, where he is general manager. This account is filled with references to IDEO's work. That's fine up to a point—the cutting-edge company is one of the largest innovation and design consultants in the world. But there are many others doing great work—ZIBA Design, Design Continuum, Jump Associates, Stone Yamashita Partners, Peer Insight, and Involution Studios, to name a few.

IDEO's Kelley delivers an insightful guide to building a creative culture

Still, Kelley's volume is a helpful reminder that innovation has changed. In the '90s it involved dealing with vast technological shifts that disrupted and threatened companies. Today it means building the processes that promote an idea-generating culture. You can learn a lot by flying. ■

–By Bruce Nussbaum

BusinessWeek online For the best of Tom Kelley's how-to advice, go to www.businessweek.com/extras

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TANDARD
POOR'S

IdeasViewpoint

BY GLENN HUBBARD

How to Fix the Pension Mess

The Pension Benefit Guaranty Corporation has grabbed headlines in recen months by taking over the pension plans of bankrupt steel and airline companies. And now auto-parts giant Delphi Corp. may be headed its way Questions about the agency's worsening financial condition create an opportunity to consider reforms—and, more important, rethink public policy relating to how Americans prepare for retirement.

The PBGC insures (up to a limit) defined-benefit pension plans, a type of employee compensation earned during one's working years but paid during retirement. To make good on this promise, employers are required to set aside funds toward this liability and buy insurance from the PBGC. The agency takes over pension plans if the sponsor becomes insolvent. The PBGC is then responsible (again, within limits) for paying the promised retirement benefits.

Two big problems have led to the PBGC's current financial woes. First, complex pension-funding rules have allowed many plans to become underfunded, especially since 2000, putting taxpayers at risk. Second, the PBGC's insurance is too cheaply priced, increasing the bite taxpayers may one day have to swallow.

THIS URGENT SITUATION must be addressed. The nonpartisan Congressional Budget Office (CBO) estimates that the present value of the PBGC's net costs for defined-benefit pension insurance —the present value of the unfunded insured liabilities of terminated plans minus the present value of premiums received—over the next 10 years is $87 billion. About $63 billion of that cost reflects losses not yet incurred—in other words, losses that might be reduced with reform. To avoid these costs, Congress would need to base premiums charged on the underlying risk of insured plans. The CBO estimates that a fair premium would be a stiff 6.5 times as much as current rates.

In addition, Congress should more closely match expected cash inflows from premium plan assets with the outflows from premium plan liabilities. In practice, this could be done by limiting the share of assets invested in equities, as opposed to bonds. Congress could also tighten rules to give companies less time to close deficits. All these reforms reduce future taxpayer liabilities. But they also raise the costs of offering defined-benefit pensions, probably reducing the number of companies that will make them available.

Any reform should increase the transparency of taxpayers' exposure to PBGC liabilities. Not only should increases in the PBGC's shortfall be accrued in the federal budget but past PBGC losses for plans that have been terminated could be funded with a one-time catch-up appropriation to the PBG

Finally, Congress could consider transferring the PBGC to private owners or even put in place private policies bought b plan sponsors from competing insurers. That would inject i the system some innovation in risk management found in th private sector. Taxpayers still must address current losses an assuming insurance is mandatory, the government would probably regulate terms of the insurance. Yet what would almost surely emerge is more costly insurance—appropriate so—and, again, reduced reliance on defined-benefit plans.

> Over 10 years, federal liability for guarantees is $87 billion. Let's spread out the risks

But is this consequence really so troubling? 25 years, participation in private defined-contribution pension plans, such as 401(k)s, b increased, from 37% to almost double that to Such plans allow workers to take pension ass with them as they change jobs, but employees bear the risk of changes in the value of their pensions. Proponents of defined-benefit plans warn of this greater asset-price fluctuation ris in defined-contribution plans. But defined-benefit plans can leave workers in worse shap given job turnover and wage fluctuation.

So rather than favoring one pension form b concentrating on PBGC reform, Congress sho think more broadly about retirement savings policy. Included in that discussion should be strong minimum benefit in Social Security for lower-incom retirees (a de facto defined benefit), slower growth in Socia Security benefits for higher-income households to control costs, and increased incentives for defined-contribution pl to help younger households bolster pension savings.

Large deficits faced by the PBGC are a political challenge that Washington will be forced to fix. Doing so without sou economic analysis and thinking more generally about retirement income would be a missed opportunity. ■

Glenn Hubbard *is dean of Columbia Business School. He chaired the Council of Economic Advisers from February, 200 to March, 2003 (rgh1@columbia.edu).*

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First Restrain Spending, Then Ax the AMT

PRESIDENT GEORGE W. Bush's tax reform panel, scheduled to complete its work by Nov. 1, seems to be zeroing in on ways to repeal the alternative minimum tax. This frustratingly complex parallel tax system, instituted in 1969, was intended to reduce the value of tax preferences claimed by the affluent. But because the AMT is not indexed for inflation, it is quickly morphing into the bane of the American middle class—expected to afflict almost 30 million taxpayers by the end of the decade, up from 3.6 million today.

Yet when it comes to trying to kill this wildly unpopular levy, the spirit is willing but the purse is weak. The AMT is expected to fatten government coffers by a remarkable $1.3 trillion over the next decade. In 2010 alone it will bring in an estimated $112 billion, says the nonpartisan Urban-Brookings Tax Policy Center. Even in a tax system that generates nearly $2 trillion a year, that kind of cash is hard to replace. And since President Bush has made talk of a tax increase off-limits, his reform panel is forced to explore funding any AMT repeal by curbing much-loved tax breaks for mortgage interest, state and local taxes, and fringe benefits.

If that sounds like a zero-sum game, you're right. Relief for any one group of aggrieved taxpayers (say, homeowners) likely would be offset by increasing tax bills for another group (say, residents of high-tax states in the Northeast or California). Add in the inevitable class warfare and the political horse trading required to make those choices, and it's easy to see how this tax-restructuring effort risks creating a cure that's worse than the ailment it's trying to treat.

For example, nearly 40 million Americans take the mortgage-interest deduction, and the huge financial benefit it gives owners—$76 billion this year alone—is built into U.S. housing prices, especially for high-end homes. So tinkering with the mortgage-interest deduction, either by giving a fixed mortgage credit or lowering the cap on deductible interest, risks spooking a housing market just now cooling from near-bubble conditions. Moreover, any hit to the prices of homes—most Americans' biggest investment—would shrink consumer wealth and borrowing power. And let's not forget that home-related borrowing has been a prime engine of consumer spending and domestic growth in recent years.

A similar danger of unintended consequences lurks in a proposal to partially tax the value of employer-paid health insurance. The plan won't raise much money right away because the $11,000 tax-free cap the panel is considering is still above the $10,000 a year cost of today's typical company-sponsored family policy. But because U.S. health costs are rising so fast, over time it could cost taxpayers a bundle. To be fair, we must note that it also would surely spur many workers to buy medical care more prudently. But, depending on whether these taxes were levied on individual taxpayers or employers (who currently deduct health insurance premiums as a business expense), taxation could either discourage companies from giving generous health benefits or reduce workers' ability to pay their share of premiums—just when Washington is struggling to deal with the growing ranks of the uninsured.

Even proposals to fund AMT repeal by eliminating the current federal tax deduction for state and local taxes paid pose problems. True, many upper-middle-class taxpayers already lose much of the deductibility of state and local taxes because of the AMT's preference-trimming methodology. But many taxpayers in high-tax states such as New York or California probably still would suffer more by losing the state and local deductions, setting up a regional fight that could degenerate into red state-blue state battle royal.

> Washington's "spend now, pay later" mentality is the greater problem

To be sure, we're certainly not opposed to calls for making the tax system more equitable or efficient. But both the Bush Administration and Congress seem to be missing the more pressing point here: Runaway government spending (epitomized by expensive porkfests such as the recent transportation bill) is a bigger problem that continues to be ignored.

Even a dramatic restructuring of the tax system is no substitute for smarter government-spending decisions. Indeed, Congress and the President's growing "spend now, pay later" mentality—at the same time the U.S. must fund mounting near-term costs for its wars in Afghanistan and Iraq—is what got us into this fiscal mess. And as more than $100 billion of unexpected Hurricane Katrina reconstruction spending ramps up, the focus on revamping the tax structure to abolish the AMT seems a bit ill-placed. Unless Washington starts making more rational, realistic spending decisions, tax reform may be the least of our worries.

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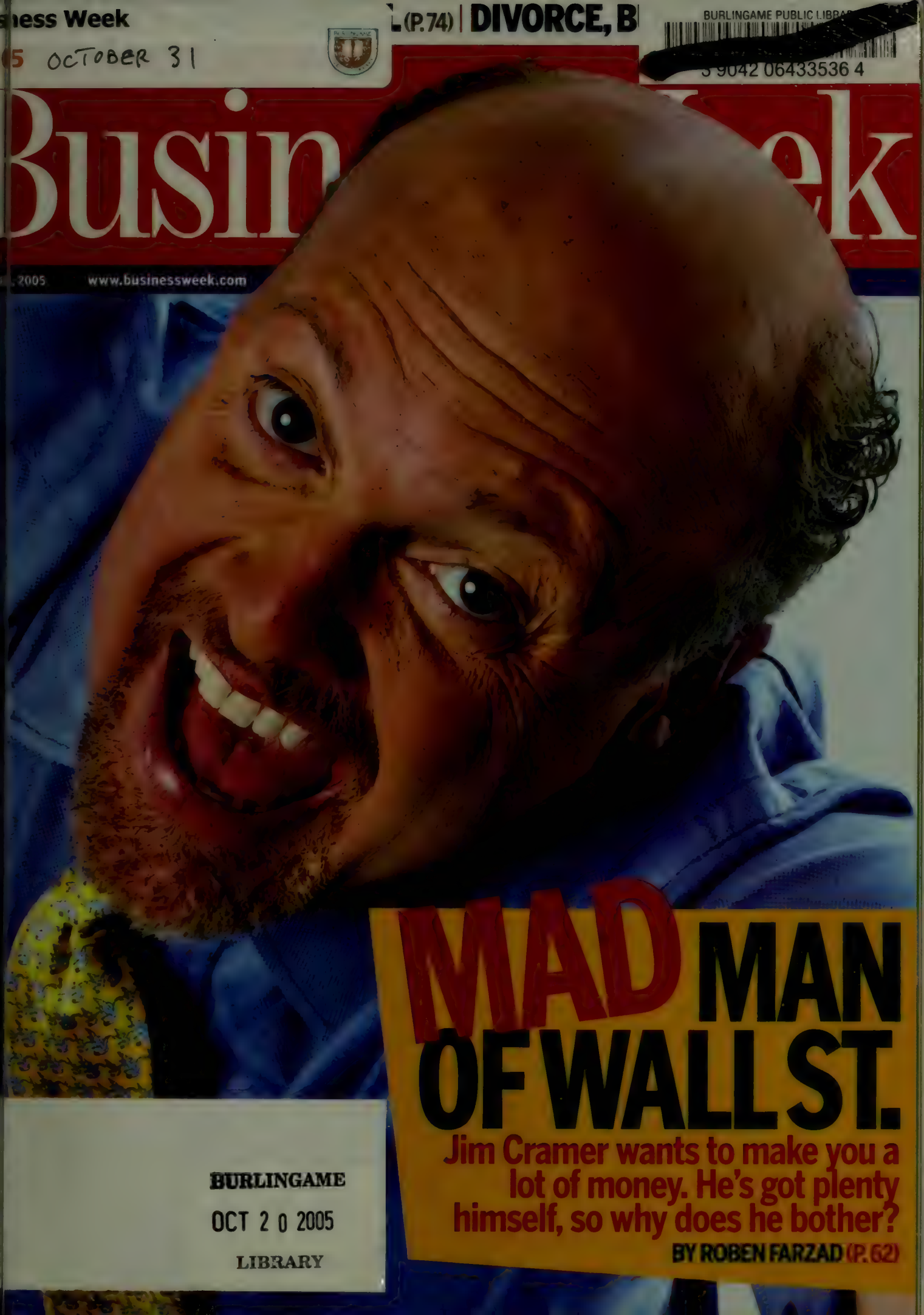

MAD MAN OF WALL ST.

Jim Cramer wants to make you a lot of money. He's got plenty himself, so why does he bother?

BY ROBEN FARZAD (P.62)

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Perfect 10!

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1 The Industry Average Expense Ratio, calculated by Fidelity, represents the median total expense ratio of no-load or front-en index funds that are in the same Morningstar® fund categories as each of the Fidelity Spartan Index Funds listed. We excluded

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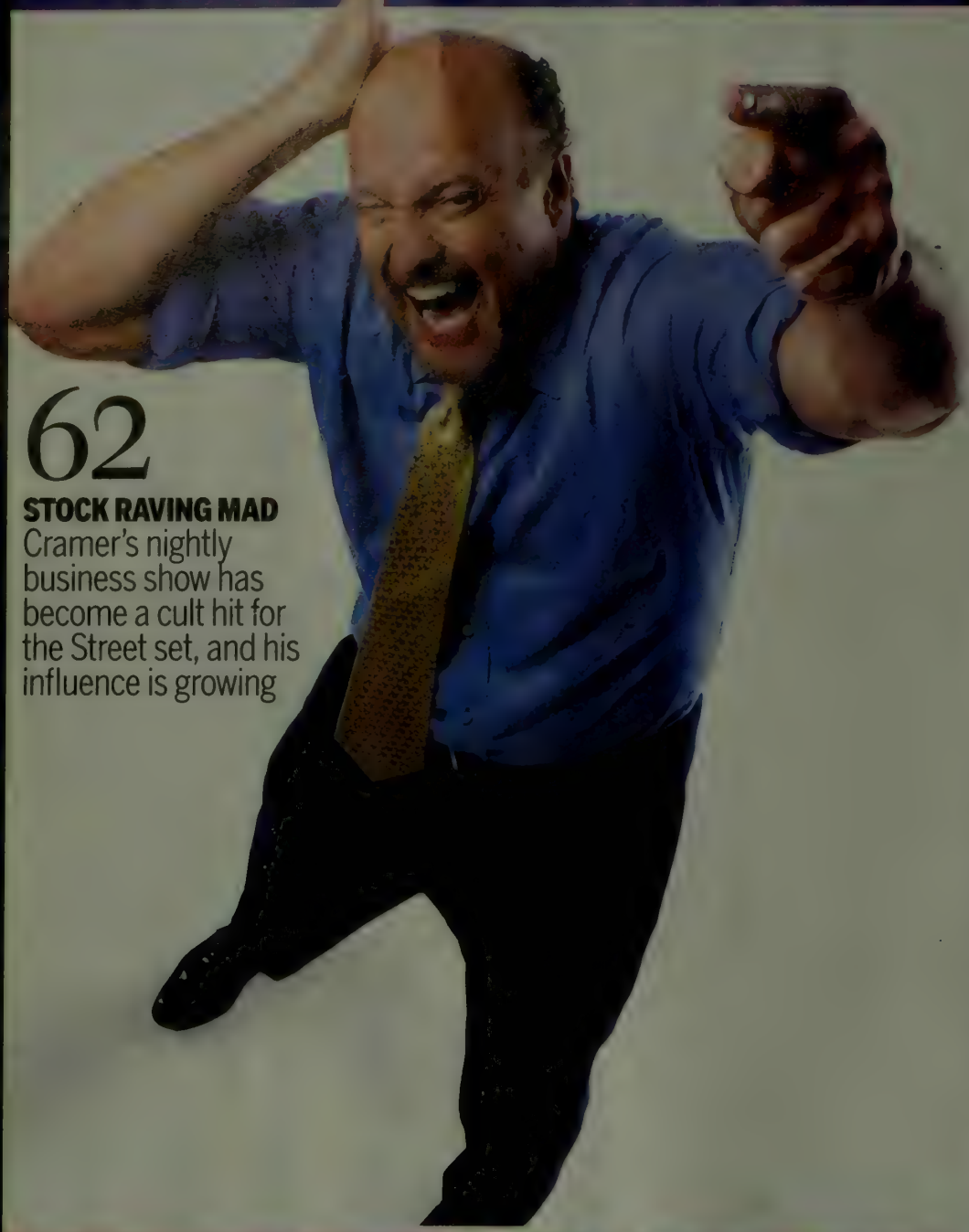

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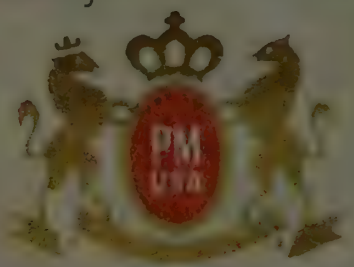
How Marlboro keeps fit at fifty



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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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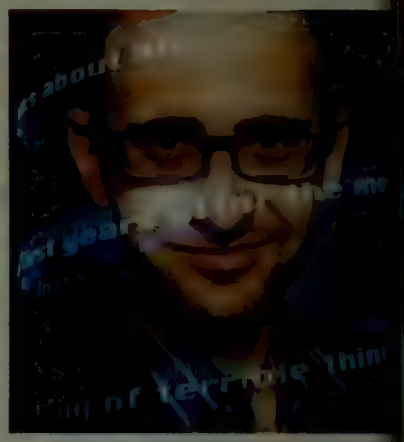
The Juiciest Take on Media In the Blogosphere



Meet our newest blogger: Jon Fine. In **Fine On Media** he offers daily the same savvy insights on media and marketing that readers have come to expect each week from our Media Centric columnist. In his first posts, he examined how ironic it would be if a **potential AOL deal** finally moves Time Warner's stagnant stock price. And he delved into **the implications** of the video iPod if users prove willing to pay to download TV episodes. You'll find these entries and more at **www.businessweek.com/innovate/FineOnMedia**

Climbing to the Top of the Apple Tree

If Steve Jobs ever steps down, Tim Cook's elevation to chief operating officer confirms him as the top candidate to fill jobs's shoes. Actually, make that to try to fill them

Cutting the Cord on Local Service

As the local phone biz fizzles, Sprint Nextel and Alltel may spin theirs off, while S&P believes CenturyTel could do well by expanding its interests

Housing: Healthy Or Hurting?

Optimists see strong September home-construction numbers as evidence that conditons are still in place for a healthy market. In the same data, pessimists find signs of overbuilding that will lead to a glut

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Some red, some black and your perspectives open up

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UP Front

"We're trying to answer the question: Can a computer game make you cry?"
–Electronic Arts' Neil Young to The Los Angeles Times *on its deal with Steven Spielberg to develop video games,*

ED BY DAN BEUCKE

BOX BLUES

AMING UP TAKE ON L-MART

NOVEMBER, expect to a whole lot about **Wal-Stores.** During the week v. 13, a coalition of lus national and local s will mount hundreds ions around the country nplain the giant's and onmental ces. re being inated by **artWatch,** a mbrella that includes everyone the **Service Employees ational Union** to the **Club,** the **United Church ist,** and **Sprawl-Busters.** is could mark the most s assault yet by the 's opponents. Hundreds gious leaders will deliver ns on the company.

Local business and union leaders will hold town hall meetings to push legislation requiring Wal-Mart to shoulder more employee health-care costs. College groups and bookstores will hold seminars and teach-ins on "Wal-Martization." Wal-MartWatch is also helping filmmaker Robert Greenwald, known for his 2004 documentary *Outfoxed: Rupert Murdoch's War on Journalism,* hold 5,000 house screenings to publicize the Nov. 4 release of a satirical movie, *Wal-Mart: The High Cost of Low Price.*

Wal-Mart isn't sitting on its hands. The company will sponsor an unusual academic conference on Nov. 4 to examine its own impact on the economy. Says Vice-President for Corporate Affairs Robert McAdam: "Our business model has proven successful for people who work for us and for our customers." *–Aaron Bernstein*

HEDGE WATCH

Call it 'Grounds for Suspicion'

HEDGE FUND SCAMS have come to this: **The Securities & Exchange Commission** has accused an Ohio stockbroker in federal court with collecting millions of dollars for a bogus hedge fund—and then pouring some of that money into his coffee shop. Gregory Applegate, 46, of Ashland persuaded about 140 investors—including retirees, secretaries, and a repair man—to give him at least $5.8 million to invest in tax-exempt securities, the SEC says in a complaint filed on Oct. 7. Instead, according to the SEC, Applegate used some of the money to prop up his **Friendzy's Coffee Shop.** An additional $76,000 was allegedly diverted to the **Ashland Community Arts Center,** where Applegate's wife was executive director. On Sept. 14, Applegate admitted to running an "illegal and unethical investment scheme" as a "side business," FBI agent Joseph Williamson says in a court filing.

Applegate's lawyer, Dennis Bartek, says Applegate will respond to the complaint and has cooperated with investigators. And the coffee shop? Bartek asked the court to let Applegate sell it. But a federal judge has frozen his assets, and some former investors are trying to force him into bankruptcy. *–Emily Thornton*

BRANDING

WHAT'S NEXT —G.I. JOE FORMAL WEAR?

RALPH, TOMMY, CALVIN... Barbie. With toy sales sluggish, companies that own characters for the kids' market have been looking for new sources of growth, including extending their brands into luxury apparel for adults.

On Oct. 20, **Mattel** introduced a line of high-end clothing to be sold at the chic **Fred Segal** store in Santa Monica, Calif., and in other boutiques. The clothing line takes its cues from Mattel's iconic doll. The toymaker teamed with a number of hot fashion labels—including Anna Sui, Citizens of Humanity, and jewelry designer Tarina Tarantino—to create items such as a sheer silk camisole with heart prints and vintage-style blue jeans with pink leather pockets. Prices run as high as $2,150 for a Judith Leiber evening clutch decorated with Austrian crystals and a Barbie silhouette.

Barbie isn't the first to join the fray. **Walt Disney** says it does $200 million a year on designer Mickey Mouse sweaters, T-shirts, and such. Last May, **Warner Bros.** introduced high-end duds featuring Tweety Bird. The theme? Natural blonde.

–Christopher Palmeri

BLOG WATCH

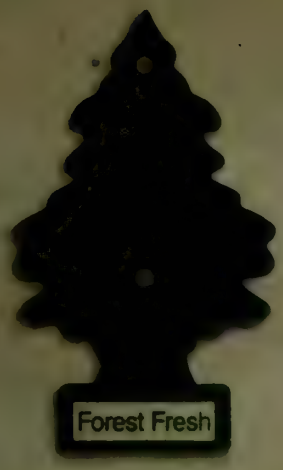
AN INDIAN LABOR SHORTAGE? That's what Kevin Barnes, 36, a software engineer living in India's tech capital, Bangalore, is finding. Barnes, tech director for StorePerform Technologies, details on his blog, Code Craft (http://www.journalhome.com/codecraft), hi troubles in landing programmers in the white hot market. Top Indian engineers are world-class, he writes, but most are taken: "Anyone India who can spell Java already has a job." And the market attracts legions of unqualifie candidates, he says, making it harder to find qualified ones. The lesson? If you're looking f software talent in India, be prepared for rigorous recruiting. *–Stephen Bak*

REALTY CHECK

A BOAT-SLIP BUBBLE IN MIAMI

THE FLORIDA REAL ESTATE boom is fueling a mania over boat storage. Miami outfits that rent out boat slips have started selling space in a new wave of luxury "rackominiums," or dry storage spaces. They've convinced many boaters—and speculators—that expanding waterfront condos will erase about 1,800 boat slips. At the **Dania Beach Boat Club**, spaces for boats as long as 52 feet go for up to $300,000. In Ft. Lauderdale, **Port Condominium & Marina** sold 100 of 125 planned slips for up to $280,000 before its opening in late October. *–Dean Foust*

DRAWN & QUARTERED



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UPFront

THE LID POPS AT RUBBERMAID

When Joseph Galli took the helm of Newell Rubbermaid in 2001, he was seen as a marketing wizard whose success at Black & Decker and Amazon.com made him the next "can't miss" CEO. But Galli did miss—badly. On Oct. 17, Newell's board announced his resignation "by mutual agreement" after 10 quarters of sliding sales.

Galli struggled to reposition Newell's myriad product lines as strong brands worthy of premium prices. He poured millions into marketing, buying ads on *Monday Night Football* and sending an army of MBAs into stores to demand better displays. That worked for higher-end lines such as Calphalon. But it was a costly mistake with commodity items like Rubbermaid containers. In September, Galli backtracked, closing a third of Newell's factories and laying off 5,000 workers. Interim CEO Mark Ketchum says the current strategy—buying and nurturing premium brands and pruning low-margin ones—should work. Newell just needs to find a better operator to implement it. *–Dean Foust*

SPORTS BIZ

ENOUGH STATS TO CHOKE THE HUNGRIEST FAN

CONTRERAS STATS noted a White Sox pitching reco

QUICK: Which **Major League Baseball** team had the highest percentage of runs scored via home runs in 2005? Answer: The **Texas Rangers**. That comes courtesy of **STATS**, the Los Angeles number cruncher which, for better or worse, is behind an explosion of statistics in football and baseball broadcasts. The company, started by a pair of math whizzes in 1980, is feeding numbers to the **Fox Sports** broadcast booth during the World Series.

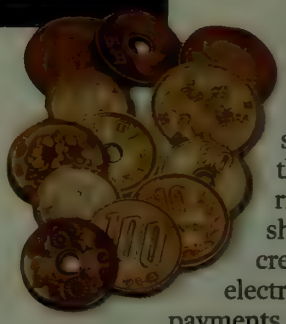
Based on STATS's record, some of those figures will prove prescient. For instance, STATS knew that the **Chicago White Sox** were the first team to notch four or more straight complete games by their pitchers in the same post-season series since the **New York Yankees** in the 1956 World Series. Other data, though, seem like they are intended for mathematicians. STATS, which also works for **CBS**, was the source of the arcane observation during a recent **NFL** game that since Dan Marino's retirement in 2000, the **Miami Dolphins** have gone 41-13 when their passers threw one or fewer interceptions but 6-24 when they're picked off two or more times.

Before game time, 15 STATS employees—mostly computer programmers a sports addicts—think up questions and pull answer from a vast database. For each World Series game th researchers will dash off a pithy 10- to 12-page statist report for the Fox Sports team. More data are sent t the booth as games progre

"We try not to be too obscure," says Don Zmind vice-president and directo research. The ideal nugget says, is one that "viewers c understand and sometime gives a clue to what will happen next." *–Mark Hym*

WIRED WORLD

COINS LOSE CACHET IN JAPAN



JAPAN HAS LONG been one of the developed world's most cash-driven economies: Bills and coins in circulation represent 14.5% of GDP, compared with 6.1% in the U.S. Japanese ATMs will cough up $18,000 at a go. In the U.S. the limit is often $500.

In July, though, the **Bank of Japan** recorded the first drop ever in the number of coins in circulation. One reason is the electronic cash stored in smart cards and mobile phones. Commuters can now pay for train fares by swiping their phones or cards against the turnstile. Some 23,000 restaurants and stores sell everything from rice balls to shaving cream using electronic payments. And nearly 6,000 vending machines accept e-payments.

The catalyst has been cellular operator **NTT DoCoMo**, which started selling phones with smart chips last year. This fall, both of its rivals are introducing e-cash handsets, too. In all, about 26 million Japanese now use smart cards and phones for small outlays, spending some $70 million a month in e-cash. In the digital age, Japan's love affair with cash may finally be ending.

–David Rocks and Hiroko Tashiro

THE STAT

21

Percent of surveyed Americans 55 or older who do online banking, down from 26% in 2004. Many feare their data might b sold by the bank or stolen.

Data: August survey by Ipsos Insight, with 277 older respondents

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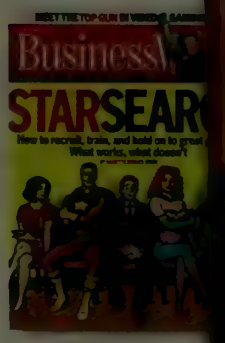
"Finance and accounting... are often over-emphasized [at B-schools] to the detriment of... talent-management skills."

–K. Michele Kacmar
Tuscaloosa, Ala.



SCOUTING TALENT: TIPS FROM TROOPS ON THE GROUND

YOU CORRECTLY NOTE that "Despite years of rhetoric about talent—and stacks of annual reports insisting that people are a company's biggest asset—most companies still don't get it" ("Star search," Cover Story, Oct. 10). What you should have added is that most business schools don't get it, either. Despite the fact that accrediting bodies such as the Association to Advance Collegiate Schools of Business (AACSB) list communication abilities, ethical-reasoning abilities, and multicultural understanding among the top six essential learning experiences for students, most business schools today do not require their students to take a human resource management course or offer HR management as a major within the school, essentially eliminating opportunities for their students to acquire talent-management skills.

Current business school curriculums and faculty compositions are too heavily skewed toward the functional specialties of finance and accounting. While these skills are certainly important, they are often over-emphasized to the detriment of the talent-management skills you justifiably highlighted in your timely arti

–K. Michele Kac
The University of Alabi
Tuscaloosa,

Editor's Note: The writer is chair of Human Resource Management Div the Academy of Management.

YOUR TITLE, "Star search," totally il trates the problem companies have finding good chief executives. To fin good manager, one looks at previous sults. To find a star, one reads the pul ity releases. But the best reason to go the manager rather than the star is way managers start their jobs. A mana can take a little time to learn the ro and change the company slowly, bu star needs to hit the ground running make a splash! In most cases (Hew Packard Co., for example) that in splash is a disaster. Go for the manag

–Stephen W
Greenwich, Co

GENERAL ELECTRIC CO. was mentio in your article on how to recruit, train, hold on to great people. But when Jeff R. Immelt was selected to lead the co pany, GE did not retain W. James McN

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ney Jr. and Robert L. Nardelli, who were the No. 2 and No. 3 leaders of the company. When GE purchases companies, the top management of those companies must wonder if they are going to be retained. (Most probably are not since GE will bring its own people to run the company better.)

Your article did not even mention Warren E. Buffett and Berkshire Hathaway Inc., which does a great job of recruiting and holding on to great people. Berkshire Hathaway has bought dozens of companies over the years and has never lost a CEO to a competing enterprise. Many of those CEOs are way over the usual retirement age but keep working hard every day, mainly to make Buffett proud.

–Doug Kahn
Vernon Hills, Ill.

GREAT ARTICLE. This and much more needs to be said over and over until human resources management is prioritized and approached in a disciplined way. The organizations you so appropriately laud worked at it hard, year after year. At these companies, at least early on, front-line operations management complained about how much time was taken up by all that people stuff. Accounts scoffed at the lack of proof of long-term value. Even HR probably complained about the increased workload. But someone high in each of those organizations had the will to keep the urgent many at bay and champion the prioritization of a disciplined approach to talent management. Hooray for those leaders!

–Thomas J. Hattersley
Cincinnati

FOR SOME CAREER "talent," being close to natural beauty is a prime consideration. I'm unsure that I qualify as "talent," but I am able to be a virtual information-technology associate at our Washington (D.C.) office while working across the country in the pristine Wenatchee Valley. The ease of lifestyle (an office on Melody Lane, next to Easy Street) is energizing, and that energy dividend gets invested right back into career pursuits.

–Thomas Jirgensohn
East Wenatchee, Wash.

IMMIGRATION COULD SPARK AN EXODUS FROM THE GOP

AS A RESIDENT of Arizona's 8th Congressional District, I know firsthand the two faces of Representative Jim Kolbe (R-Ariz.) ("Whipsawed on the border," Government, Oct. 10). He talks tough, but his actions are decidedly not in favor of doing anything to deal effectively with the disaster of illegal immigration. The most surefire way to stop illegal immigration is to require that all employers verify the authenticity of all federal work-authorization documents (i.e., Social Security numbers and/or visa documents, forgeries of which can be purchased for a few dollars on any street corner in Tucson or Phoenix). But there is not a single member of Congress who will even contemplate such legislation.

The real question for the Republicans is this: Will the number of culturally conservative Hispanic voters who might support Republicans exceed the number of defections of disgusted Republican voters who will support Democratic or third-party candidates—or simply stay home?

–Rick Cunnington
Tucson

WHEN ILLEGAL immigrants respond to border-control law enforcement with aggressive violence, such as firearms and rock-throwing, it is no longer "immigration." It's an invasion. It's time for the President and his advisers and Representative Kolbe to understand that. If they don't, by 2008 a good part of their base in the Republican party will be voting f[illegible] someone who does.

–Jack Greg[illegible]
Anderson, S[illegible]

CORRECTIONS & CLARIFICATIONS

A table in "The best executive MBAs" (Special Report, Oct. 24), "The top 25 EMBA programs," incorrectly stated the tuition for the program offered by the University of Southern California. The correct tuition is $83,000.

"Promise keeper" (Voices of Innovation, Oct. 17) should have read that local chapters distribute 75% of the money they collect from Race for the Cure events for community education and screening.

TWO CONTRADICTORY TAKES ON DELL

RE "HANGING UP ON Dell?" (Information Technology, Oct. 10), the signs pl[illegible] out like an ancient Greek tragedy: 1) B[illegible] sure that your customers must keep b[illegible] ing big by making upgrades that [illegible] difficult without replacing the entire m[illegible] chine; 2) Cut back on service—availab[illegible]

ality, or both—and train your cus-
rs to gradually expect less of you;
ke it clear that time is worth money
f it is Dell Inc.'s time; 4) Divide your
mers into classes, improving your
e for some (business sector) but not
s (private sector); 5) Blame the oth-
or being "too demanding" after
ing up a brand of second-to-none
mer service for years; 6) After al-
g your product/service to degrade,
e extra for the offerings you built
brand upon; 7) Allow your market
and stock price to fall before cor-
g the problems.

t's not be too harsh on Michael S.
nd his management team, though.
didn't invent the Wall Street game
ewards shortsighted focus on num-
as much or more than long-term,
y, and robust growth through a well-
ced and sensible business model.

–Jennifer Kirley
Greene, Maine

XPERIENCE WITH Dell dates back
95, when I purchased my first home
m. I had to reach out to Dell on nu-
us occasions for technical advice and
st always received fast and effective help. But not much can top my most recent experience, when I discovered the dreaded "blue screen" and could not open Windows on my eight-month-old Dell desktop system. I called support at 9:15 a.m. on a Sunday morning. A technician worked with me for more than an hour. No success, so he had to run a repair program. He phoned me a few hours later to check my repair status. The program was making little headway, so he requested a service call to replace my hard drive. I received an e-mail on Monday morning directing me to call their designated field-repair service. The field technician was at my door at 1:00 p.m. and had my new hard drive installed and was reloading the Windows operating system within 10 minutes. Total down time was less than 30 hours, which I consider exceptional.

–Ted Paquette
Alpharetta, Ga.

THE PREDICTABLE DISASTER OF MEDICARE'S BIG EXPERIMENT

RE "MEDICARE'S big experiment" (Social Issues, Oct. 10): Physicians are pretty smart people, and they will quickly sort out how to maximize their reimbursement based on quality of care. Predictable unintended consequences: physicians less willing to take on medically fragile or complicated patients, who by definition have negative impacts on traditional quality-of-care markers, and physicians less willing to practice modern pain management—just in time for the largest retiree population the health-care system has ever seen.

Increased data on individual treatment decisions also make it easier for politicians with a "moral" agenda to ferret out physicians who make treatment decisions that run counter to that agenda (think Terri Schiavo). Pay such physicians less and they become extinct, all the while saying that government is not "telling physicians how to practice medicine."

It's one of those deals that sounds good on paper yet is easily hijacked at a later date.

–Dewey Clark
Glen Arm, Md.

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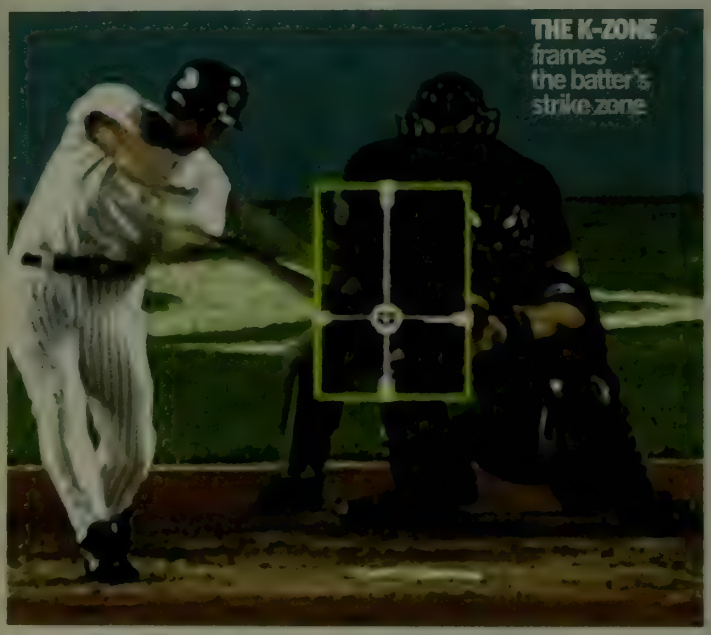
Virtual Virtuoso

ON SEPT. 27, 1998, the Baltimore Ravens and Cincinnati Bengals clashed in a football game that would have been forgotten long ago if not for Stan Honey. He didn't pounce on a fumble or score a touchdown, but the scientist was the undisputed star even though fans in the stands noticed nothing different.



Stan Honey is changing the way fans see sports on TV

On the couches and La-Z-Boys of America, however, it was a different story. The TV audience was knocked out by an electronic yellow string stretched across the field like a fuzzy clothesline. ESPN had unveiled Honey's head-snapping invention, the virtual first-down line. It wasn't really on the field, of course, but through the genius of Honey and his team of scientists at Sportvision Inc. in Chicago, it sure seemed like it. After fans got over the shock, they loved how it made the game easier to follow. The virtual first-and-ten line is now a staple of network football coverage. "It's become so much a part of the fabric of [football on TV] that if people don't see it, their reaction is that the telecast is substandard," says Jed Drake, an ESPN senior vice-president.

In the 1960s, slo-mo and instant replays changed the way fans watched televised games. Now, Honey is leading a high-tech revolution at least as eye-catching. Sportvision has been rolling out gadgets for all the major sports, including the PGA Tour, NASCAR, and Major League Baseball, for which it whipped up "K-Zone," a virtual box that frames a batter's strike zone and pinpoints the locati of each pitch. The latest gee-whiz creation from Honey's l will debut during Fox broadcasts of the World Series, whi begins on Oct. 22. "PITCHf/x" will track the arc of pitches giving fans a better look at how a curveball curves and a fastball darts.

In college, Honey might have been voted least likely to reinvent sports on TV. An electrical engineer educated at Yale and Stanford, his early interests included meteorolog and developing radar to detect underwater ice. In 1983 he helped start Etak Inc., which pioneered auto navigation a digital mapping before being sold to News Corp. in 1993.

Honey, 50, went to work for News Corp. its chief technology officer just as Rupert Murdoch was nabbing National Hockey League games for Fox. Soon, Honey and F Sports CEO David Hill were brainstorming ways to jazz up the NHL, a ratings slacker. Out of the talks came a wild idea: electronically "lighting up" the puck, maki it easier to follow on TV. The glowing puck took to the ice in the 1996 NHL All-Star Game. While ratings improved, "the diehards whined and complained, but they still watched," recalls Honey.

When Fox and the NHL parted company three years later, the plug was pulled on the glowing puck. But Honey had the makings an innovative business. These days, investm in privately held Sportvision, which Honey co-founded in 1998, include Motorola, Roy Disney, Chicago White Sox owner Jerry Reinsdorf, and Washington Capitals owner Ted Leonsis.

Honey is far from the geek his résumé might suggest. When PITCHf/x first pops u on TVs, Honey, an avid sailor, will be hunkered down in Spain awaiting the start of November's Volvo Ocean Race. He's the navigator for Team2 ABN-AMRO in the seven-month, around-the-world race. "It was kind of like being a Dodger fan and getting a call to put your uniform on," says Honey.

While Honey charts a course, Sportvision engineers are working on the Next Big Thing. One of the biggest, says CEO Hank Adams, is a new generation of data-fed computer game that will blur the line between real and virtual sports. How blurred? Soon a race-car game may put a joystick jockey on th track with real NASCAR drivers tearing around a real oval in real time. "Ultimately, we want to put you in the race," says Adams. Thanks to Honey, that's no longer a virtual goal. ■

–By Mark Hym

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BY STEPHEN H. WILDSTROM

The Way to a Google Office

One day in the not-too-distant future you sit down at your keyboard to check your messages from Google's Gmail, then fire up Google Word to write a couple of letters. Next you work on a presentation on new busines locations in Google Point, incorporating maps from Google Maps and satellite imagery from Google Earth. A world in which software from Google has replaced much of today's Microsoft hegemony seems far-fetched. But advances in technology and the hints dropped by the very secretive Google suggest that it could become a reality a few years down the road.

The most interesting recent development was the Oct. 4 announcement of a strategic alliance between Google and Sun Microsystems. The only detail revealed was an insignificant plan for Sun and Google to distribute some software for each other. In the longer run, however, this could be a big deal indeed for computer users, especially at home, in schools, and in small businesses.

A Google-Sun alliance, if it flowers, could take advantage of new technology for running applications on the Web, one that eliminates the sluggishness and limited functions of traditional Web-based programs. The most widely used approach is based on an industry standard called Ajax, and a second method uses Macromedia Flash. Either can produce programs that look and feel like the desktop ones running on your hard drive. Screens redraw nearly instantly, and you can use the mouse to drag and drop text or other objects. Yahoo!, EarthLink, and Microsoft's Hotmail are testing mail services that, in speed and responsiveness, behave more like Outlook than like clunky Web mail. Google Maps is also a showcase for this technology.

THE KEY TO ANY GOOGLE APPLICATIONS package could be Sun's StarOffice, a desktop productivity suite that matches Microsoft Office program for program. StarOffice costs $75 for Windows or Linux, or you can download a similar package for free from OpenOffice.org. While lacking some of the polish of Microsoft Word or Excel, StarOffice is more than adequate for most consumer, educational, and small-business uses. It can now accurately read and write files in Microsoft formats—something that was problematic in earlier versions. The main difficulty is with documents that have programs, or macros, embedded within them. StarOffice uses a different programming language and can't run custom Microsoft programs without conversion. But this is an issue mainly for corporate users.

Google and Sun would face formidable challenges if they decide to turn StarOffice into a Web-based suite. The technical job of reworking the suite into software suitable for Web deliv is a big one. On the plus side, S and Google both have deep knowledge of how to run the s of large, complex network that would be required.

The business hurdles may b even greater. Although the ren of Web-based software has gained some traction among companies—Salesforce.com's customer-relations-manageme program being a prime example—it will likely be a tou sell to consumers. And it is ha to see how Google's basic mod of selling ads closely tied to content could work with a wor processor or spreadsheet. But Google has been good at finding ways to make money from services, such as search and free e-mail, where no one else saw much chance for profit.

Your office suite could come to you straight from the Net

Nothing Google or anyone else does is going to disrupt Microsoft's hold on corporate desktops. Most companies h invested too much in an Office-based ecosystem to conside changing. But other markets, including education, could b up for grabs, especially if Google were to devise an offering that was easy to use and free of the ever-increasing bloat o Office features that only interest corporate users. If Micros executives aren't worried, they should be. ■

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Samsung the Network

Let's say you buy several million dollars' worth of Internet advertising. Let's say you long ago staked out prime property, like page-topping banners on the home page of time.com. Let's say you have such space on more than 400 sites. ¶ This being the Web, these ads are neither static no one-way. They can link to other sites, should consumers be given a good

reason to click. It occurs to you: This is a network in and of itself. You can use your collective ad buy to leverage partnerships with other marketers. You have essentially blurred the line between advertiser and medium.

Such is the story with consumer-electronics darling Samsung. Its ads not only promote its own wares but also sometimes other big mainstream entertainment products, be it *Fantastic Four* or releases from Jon Bon Jovi and The Who. "Hi, Hollywood. You would like to reach 175 million people in 30 days?" deadpans Peter Weedfald, Samsung's senior vice-president for consumer electronics and North American marketing. "We can do it."

There are many arrows in Weedfald's quiver—all that choice Web real estate, Samsung products' natural fit with entertainment, musicians' need to promote themselves independently of labels' efforts, and his own ultra-audacious, buzzword-studded selling style. With them all, Weedfald is proving there's life left yet in the lowly Web banner ad, and in the tattered mass-marketing model itself.

INTERNET SPENDING by Samsung Electronics—that is, its consumer unit—tripled between 2001 and 2004, to $11.5 million. It accounted for slightly more than 14% of its measured media spending for the first half of 2005. Samsung also boosted its advertising on network TV and in magazines, but it has, perhaps unwittingly, created competition for traditional media by becoming something of an ad vehicle itself. "Let us be your advertising, marketing, publishing, creative" partner, says Weedfald, warming to an imaginary audience. "We get to burnish Samsung by standing next to Jon Bon Jovi. He gets a vast distribution network."

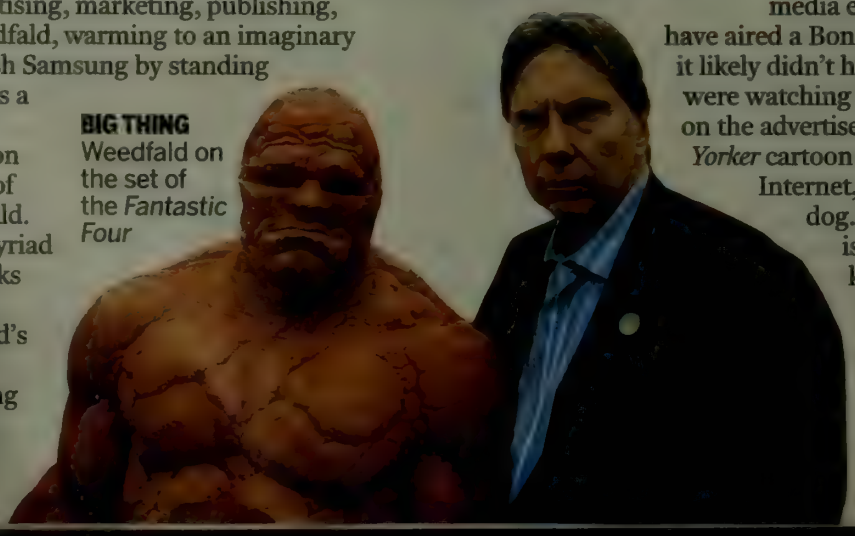
Using ads as a distribution mechanism is a byproduct of the bigger game for Weedfald. As a mass marketer with myriad product lines, Samsung seeks ubiquity and repetition. (Googling some of Weedfald's pet phrases—"the ADD economy," the Internet being "Darwin on speed"—aptly proves that he practices what he preaches regarding repetition.) Weedfald, a former tech-magazine executive, loves publishing metaphors. "I want Jon Bon Jovi. I believe his audience—his circulation—and what he stands for," he says. "The unique editorial is his music, and his genius around the music." (You were warned about his selling sty What is a network without content?

A full-court promotional press for Fox's *Fantastic Four* la summer involved Net and traditional media ads and in-sto displays at Best Buy. Actual money that changed hands between Samsung and the studio: zero, as Samsung traded o Net bona fides for multiple product placements in the film. "Samsung's Internet reach is so pervasive," says Lisa Licht, Fox's senior vice-president for global marketing partnershi "Think where moviegoers are: They're on the Internet for a significant portion of the day." Samsung just announced a d with The Who in which buyers certain Samsung systems get fi Who DVDs—a deal promoted, course, by its Web presence. La year, Samsung sponsored a We cast of a Bon Jovi concert, fram by what looked like a Samsung TV, and grabbed 125,000 viewe 87% of whom stuck around for the nearly two-hour show.

Blurring the line between ads and media like never before

Uncomfortable as it may m media executives who might o have aired a Bon Jovi concert themselve it likely didn't hit Web users that they were watching another turret crumbl on the advertiser-media wall. The old *Yorker* cartoon tells us that on the Internet, no one knows you're a dog. The Samsung corollary is: On the Web, no one knows you're not a medium. Even if you ac like one. ■

E-mail: jon_fi businessweek.c



BIG THING Weedfald on the set of the *Fantastic Four*

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The Barker Portfolio

BY ROBERT BARKER

Catalog IPOs: Wait for a Sale

You know Harry and David? Sure you do, especially this time of year when your mailbox fills with catalogs featuring pears, five pounds for a mere $25.95. Not as arresting as a flock of angels from Victoria's Secret. Yet at the holidays, a membership in the Fruit-of-the-Month Club might be a perfect gift for Aunt Ida.

Harry & David Holdings has been shipping gift baskets since 1934, when founders Harry and David Rosenberg branched out from their Medford (Ore.) orchards. This holiday season, however, the company isn't only selling fruit. It also is preparing to sell part of itself in an initial public offering. The deal faces competition, as another familiar cataloger, J. Crew Group, is coming public, too. Neither offering has reached the point where the sellers estimate how much they hope to fetch for a piece of their action, and executives at both companies are keeping quiet before their IPOs. Just the same, their securities filings are full of details about their financial positions and prospects for their businesses (table). Here's how I size up each:

BALANCE SHEET BLUES Both Harry & David and J. Crew are laden with debt

» **Harry & David.** In the year since a pair of private-equity funds took over in June, 2004, Harry & David has enjoyed nice jumps in total sales (8.4%) and operating income (95%), the latter driven by trimming the workforce and other costs. The company also operates 135 retail outlets, where comparable-store sales accelerated impressively, 8.7% vs. 1.7% the year before. Sales at its Jackson & Perkins garden gifts unit (13% of total sales) fell 5.5%, however, the unhappy result of a new rose-growing technique that reduced yield.

For prospective investors, Harry & David's allure is a w established, consistent business. The trouble is its bruised balance sheet. At last report, the company owed more tha $226 million in net debt and accrued interest. That was enough to wipe out shareholders' equity, which turned negative after a refinancing this year that allowed Harry & David's private-equity owners to recoup their original equ stake of $83 million. (Throw in the debt, and the total buy price was $253 million.) Whatever they raise from the pu now will be gravy, and you can bet they will aim for a valuation far above their cost. Tha worked out to be a steal—six time the coming year's earnings before interest, taxes, depreciation, and amortization. Harry & David's IPO should prove a treat—for sellers.

» **J. Crew.** From its 1983 origins i catalog sales of preppy apparel, J. Crew has evolved via a strategy o developing multiple retail channe Its 202 stores today take in 70% o total sales; Web orders are runnin 75% higher than catalog sales. Le since 2003 by Millard Drexler, Ga erstwhile impresario, the business making some nice noises. J. Crew' past five quarters brought higher comparable-store sales and operating income. Sales per square foot, $73 in the first half of 2004, ran $100 in this year's first half. All good.

Yet apparel retailers, always anticipating—if not creatin the next fashion, are inherently riskier than a seller of pea and fruitcakes. One worry for investors is that Drexler's contract permits him in January to step down as CEO and then serve only as executive chairman. Bigger worries ap on the balance sheet, which is laden with $667 million in borrowings and preferred stock. Texas Pacific Group, a pri equity firm that in 1997 bought control Crew, plans to swap preferred stock and notes it holds for common stock. Drexle who also plans to exchange debt for equ will hold 15% of J. Crew as the company goes public.

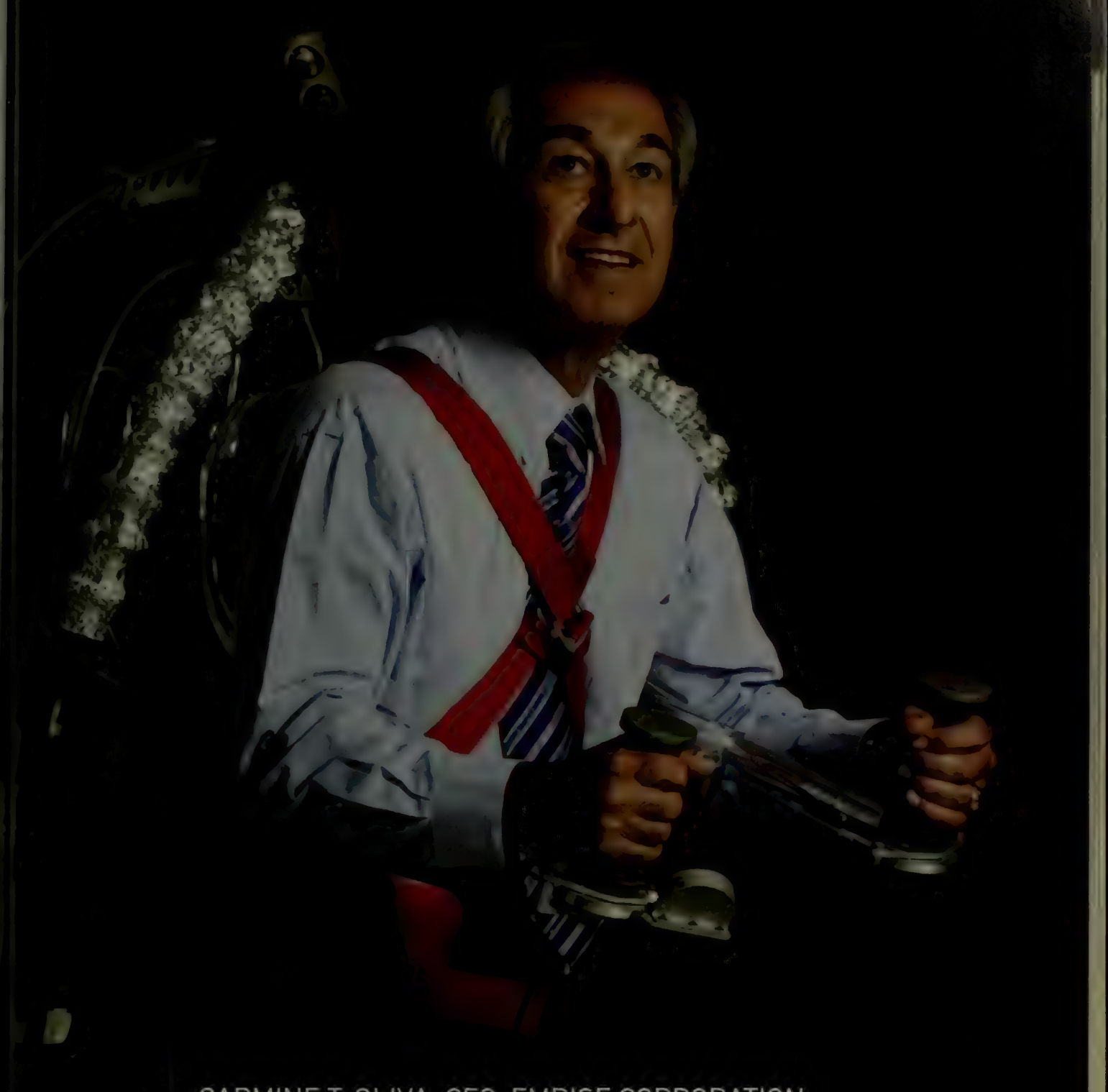
Obviously, neither deal has me reachi for my checkbook. What might change mind? If the American consumer, again all experience, falls into a deep swoon. Then, look for markdowns in the stocks.

E-mail: rb@businessweek.

What's in Store

COMPANY	REVENUE	OPERATING INCOME	CASH	TOTAL DEBT AND PREFERRED STOCK	SHAREHOLDERS' EQUITY	TENTATIVE SYMBOL
	MILLIONS					
Harry & David Holdings*	$566	$28	$25	$245	-$20	HND
Also owns Jackson & Perkins, purveyor of the Ronald Reagan and Princess Diana roses						
J. Crew Group**	$910	75	30	696	-$580	JCG
Plans to launch a line of children's apparel under the brand crewcuts						

*Data for 12 months ended June **Data for 12 months ended July **Data:** Company reports



CARMINE T. OLIVA, CEO, EMRISE CORPORATION

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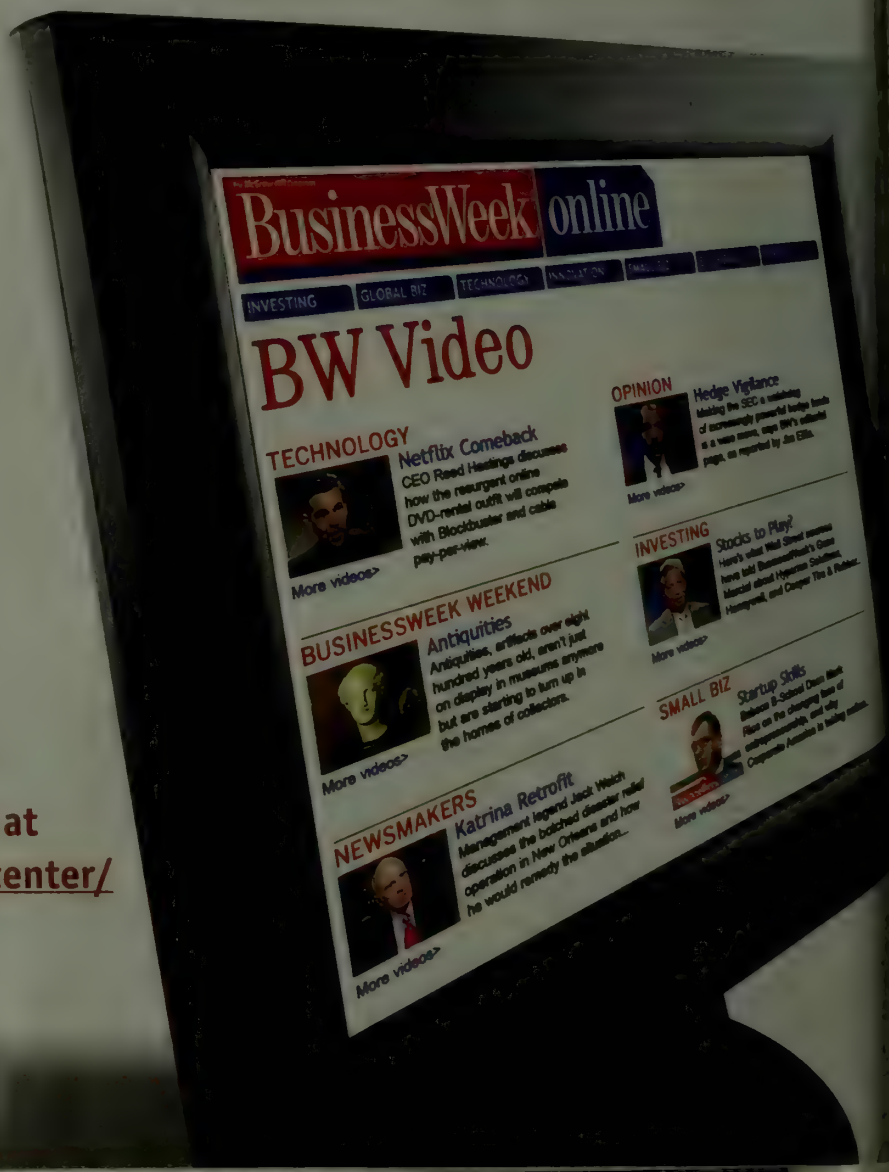

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AMES C. COOPER & KATHLEEN MADIGAN

GM Adds One More Brake On Inflation

with demand strong, many businesses will have the power to lift prices

U.S. ECONOMY General Motors Corp.'s decision to slash its retirees' lth benefits is largely seen as another step in the restructuring of U.S. auto industry. But there is a broader implication. GM's plan l also transform inflation expectations over the long run. Global npetition, immediate access to information, deregulation, and the ctivity imperative all have exerted a structural ward push on inflation over the past decade. GM's move shows how companies are increasingly ing benefits to keep cost pressures in check.

inflation hawks, this business strategy comes at a icial time, since it will help to offset the rising al pressures pushing up core prices, which exclude y and food. Bear in mind that just as with other mic trends, inflation bends to the will of both ural and cyclical forces. And at this stage of the ess cycle, strong demand, rising rates of capacity ation, and shortages of some skilled labor have the tial to push up prices. That's especially true since ornly high energy bills give businesses a compelling n to mark up their product prices.

e tug of war between structural vs. cyclical inflation is long-running, but today's conflict has a new cy: The economy is quickly using up its available and capital. When the economy is operating at full ity, wage and price pressures are harder to combat e the favorable structural trends.

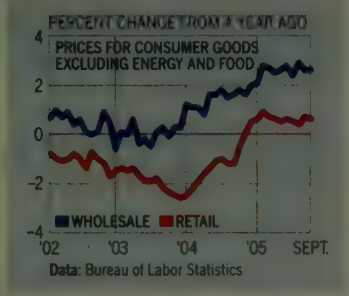
at's why the Federal Reserve remains intent on ving all monetary stimulus from the system to e that inflation remains contained. And given the my's resilience, as seen in much of the post-Katrina the Fed may have to move policy into an outright ctive mode, with even higher interest rates, if high y costs are passed through into core inflation.

t to the extent that the business sector remains on limiting its labor costs, any cyclical rise in on will bump up against the downward pull of ural forces. In effect, GM's action today may give ed greater leeway in fighting inflation in the future.

NEAR-TERM PRESSURES on inflation continue to nevertheless, and that's what the Fed and financial ets are focused on (chart). True, the September mer price index offered little to worry about. te the 1.2% jump from August, boosted by a record urge in energy prices, the core index barely budged, a scant 0.1%. No energy pass-through there.

t the month's producer price index was less benign. er energy caused the overall index for finished goods to jump by 1.9%, including a 0.3% rise in the core PPI. Most noteworthy, core prices in the earlier stages of processing showed some signs that higher energy quotes are working their way into the costs of other goods. The core PPI of semifinished intermediate goods posted the largest monthly jump in 17 months, with big increases for plywood, plastic resins, industrial chemicals, and steel mill products. Among crude materials, prices for iron and steel scrap climbed nearly 23%.

MORE PASS-THROUGH OF ENERGY COSTS TO COME?



Data: Bureau of Labor Statistics

Patterns like that make Fed policymakers uneasy, especially when economic conditions are increasingly conducive to greater pricing power. In the Fed's regional *Beige Book* report on Oct. 19, a number of Fed districts noted increased upward pressure on wages, and all districts reported cost hikes for energy, building materials, and shipping. Most important, the Fed said "several districts indicated that input cost increases are being passed through to retail prices."

RECENT INFLATION CONCERNS stem mainly from a change in the view of how oil affects the economy. Last year, conventional wisdom said that a doubling of oil prices would hammer demand. Slower economic growth, combined with intense global pressures, would assure enough slack in the labor markets and in industrial capacity to snuff out any nascent pricing pressures.

But it's not working out that way. The post-Katrina economy looks surprisingly strong. Take September retail sales. Excluding the drop in car buying because of the end of discounts and the rise in gasoline sales due to higher prices, the other 70% of retail sales rose by 0.6%.

Demand for capital goods is also hanging tough. Although the Conference Board reported a decline in business confidence last quarter, to a four-year low, the survey showed businesses have not appreciably altered their capital-spending plans. And overseas sales are

booming. Exports of goods, adjusted for inflation, rose 2.5% in August, and since March they have grown at the fastest pace of any five-month period since 1997.

Solid demand explains why U.S. industry is faring so well—and why some sectors are enjoying more pricing power. Industrial output fell 1.3% in September, but the Fed noted that, excluding the hurricanes and the Boeing Co. strike, output would have risen 0.9%. Moreover, production capacity is tightening. In September, more than a third of U.S. manufacturers were operating at greater than 82% of their capacity (table), a level typically associated with increased pricing power.

IF INFLATION PRESSURES look so intense, then why isn't the 10-year bond at 5.5% instead of 4.5%? Because bond traders as well as other inflation-watchers recognize that structural forces will work to keep inflation at bay.

First and foremost is global competition. Foreign producers are keeping prices low to maintain their U.S. market shares. That limits how much American manufacturers can raise prices. Plus, more open foreign economies have allowed U.S. businesses to move production to lower-cost overseas facilities. That gives employers an advantage over workers even as the jobless rate has fallen to 5%.

Businesses have used that edge to hold the line on labor costs. That's especially true for benefits since, as GM knows, companies can be on the hook for perks long after workers have retired. The growth in benefit costs has slowed from a 7.3% yearly pace in the second quarter of 2004 to just 4.9% in 2005's second quarter. When the Labor Dept. releases its third-quarter report on Oct. 2[illegible] the data will probably show a further easing.

Mostly, companies have focused on health-care cos[illegible] They grew 6.3% in the year that ended in the second quarter, vs. 8.1% in the same period in 2004 and 10.3% [illegible] 2003. Pensions also a[illegible] concern. In particular, airline bankruptcies h[illegible] pushed pension obligations onto the government.

INDUSTRIES WITH HIGH OPERATING RATES

	PERCENT OF FACTORY OUTPUT	UTILIZATION RATE
Plastics	4.0%	86.2%
Petroleum	2.0	84.5
Paper	3.2	84.2
Motor vehicles	8.5	83.9
Electrical equip.	2.6	82.8
Food & Beverage	13.5	82.4
Machinery	6.7	82.1
All manufacturing	100.0%	77.9%

Data: Federal Reserve

Businesses have use[illegible] the higher trend in productivity to hold do[illegible] unit labor costs. Beside[illegible] that structural shift, technological innovati[illegible] allow data to be availa[illegible] immediately. Executiv[illegible] can anticipate delivery delays and manage inventories better. And the Internet gives consumers easy access to pricing information or discount retailers. Finally, deregulation has opened markets. And greater competi[illegible] leads to lower prices. Just ask the airlines.

Or GM. Critics have said it waited too long to recog[illegible] how the economy has changed. But the auto giant has begun to move. While core inflation seems sure to rise [illegible] the coming year, GM's actions are part of the structura[illegible] forces that will limit how high inflation will drift. ■

TURKEY

Big Blows from High Oil—and Avian Flu

NO ONE EXPECTED Turkey would find a quick or easy path to membership in the European Union. Some EU nations had voiced worries about allowing a poor, predominantly Muslim country into the EU, and it took some last-minute political moves in early October before Turkey could even begin formal membership talks, a process that could last a decade.

To be sure, Turkey has made strides in stabilizing its economy since reforms began in 2001. Second-quarter real gross domestic product was up 4.2% from previous-year levels, and the jobless rate in September stood at 8%, down from 11.5% at the start of the year. Yearly inflation ended the third quarter at 9.1%, from nearly 70% four years ago. With inflation less of a problem, the Bank of Turkey was able to cut its target interest rate by a quarter-point, to a record low 14%, on Oct. 11.

HIGHER OIL PRICES DIM THE TRADE OUTLOOK

Data: International Monetary Fund

Notwithstanding such progress, Turkey's outlook has changed dramatically since the EU talks began. Because oil prices have not fallen as much as expected, the already huge current account deficit is sure to widen. The gap hit a 45-year high of 5.1% of GDP in 2004 and will approach 6% in 2005. Economy Minister Ali Babacan told the *Sabah* newspaper that higher oil prices widened the gap by $7 billion in the first seven months of 2005. Standard & Poor's has warned that if energy costs stay at current levels, Turkey's credit ratings coul[illegible] downgraded, making it more expensive to raise funds overseas [illegible] finance the deficit.

The government had planned o[illegible] using money from tourism to fund the current account deficit. But the outlook for tourism took a dive aft[illegible] cases of avian flu were found in Turkey's poultry. If the EU issues [illegible] travel advisory against Turkey, tha[illegible] would severely cut into tourism revenues, which account for almos[illegible] 20% of the economy.

For now, foreign direct investm[illegible] is helping out. JPMorgan Chase & [illegible] estimates that it will total almost $[illegible] billion in 2005, up from just $1.3 [illegible] billion in 2004. That should be enough to finance 30% of the gap. The danger is that a ratings downgrade or the spread of the av[illegible] virus could hurt Turkey's econom[illegible] coming quarters. ■

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BANKING

THE BIGGEST IPO ON EARTH

U.S. investors are lining up to buy into China Construction Bank—and a rich, new era in financial markets

BY BRIAN BREMNER

NEVER ACCUSE THE Chinese of thinking small. The global public offering in late October of China Construction Bank, the mainland's third-largest bank, is set to raise a head-turning $8 billion. That's the biggest IPO on the planet this year, and the biggest anywhere since Kraft Foods went public in 2001, according to market tracker Dealogic. The offer is vastly oversubscribed as investors line up to buy a piece of an institution with $521.8 billion in assets—the first of China's Big Four state-owned banks to publicly list shares overseas. Even the prospectus, a directory-thick document riddled with footnotes and warnings, is one of the hottest books in Hong Kong, a city legendary for investor zeal.

Construction Bank's offering, though, is far more than a Chinese affair. U.S. institutional investors have been crowding in to hear the pitch from Chairman Guo Shuqing, who just completed a road show in the U.S. to keep enthusiasm stoked. American buyers are looking for a repeat of last August's China frenzy, when Baidu.com Inc., a Beijing search-engine outfit, blew away a five-year record on NASDAQ for best first-day trading performance as its stock jumped fivefold, to $154 per share. Baidu has since cooled off, but it's still up 140% over the initial price.

STUPENDOUS RETURN

YET THE DEAL is in a different realm—one in which the big boys are playing. Construction Bank already has the backing of Bank of America Corp., which paid $2.5 billion for a minority stake this summer and will pay another $500 million at the offering. BofA is just one of several major banks and investment banks, including Citigroup, HSBC Securities, Goldman Sachs, and American Express, that have ponied up some $20 billion to buy into China's financial institutions, the biggest of which have plans to go public in the next year or so.

What's the motivation? For one, the thrill of finding a hot stock. Steven L. Wharton of Morgan Stanley Financial Services, which holds BofA shares, figures the U.S. bank bought its CCB stake at 1.15 times book value. A smaller Chinese institution, Bank of Communications, went public recently at 1.6 times book. By that logic, he notes, CCB's IPO will do the same or better—implying a nearly 40% paper gain for BofA since it cut the deal. (Morgan is also co-managing the CCB offering.)

That's a stupen-

GIMME GIMME CCB's prospectus is a hot read—even though it reveals cases of theft and embezzlement

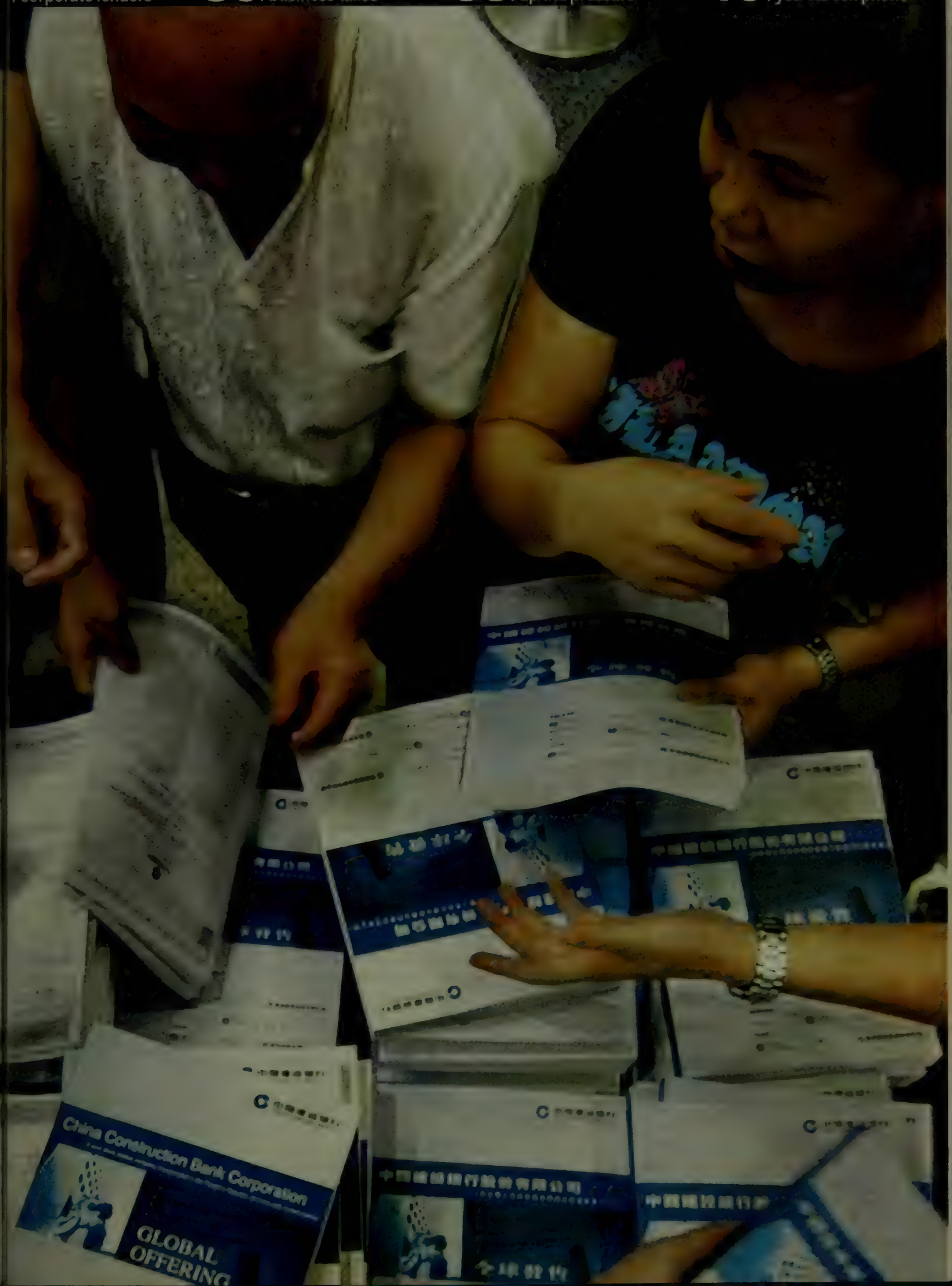
IN THIS SECTION:

Hedge funds, the new corporate lenders

36 An ugly split over business taxes

38 GM: Kerkorian keeps up the pressure

40 Services that track you via cell phone



SHENZHEN Is CCB too dependent on risky real estate loans?

The Buy China Syndrome

Foreigners are scrambling for a piece of Chinese banks

CHINESE INSTITUTION	FOREIGN OWNERSHIP	STA
CHINA CONSTRUCTION BANK	Bank of America Temasek	9. 5.
BANK OF CHINA	Royal Bank of Scotland UBS Temasek	5. 1. 10.
INDUSTRIAL & COMM. BANK OF CHINA	Goldman Sachs, Allianz, and American Express	10.
NANJING CITY COMM. BANK	BNP Paribas	19.
HUA XIA BANK	Deutsche Bank Sal. Oppenheim Jr.	9. 4.

*Non-binding agreement **Data:** Moody's Investors Service, Business

dous return of nearly $1 billion in less than three months. But what really has BofA, Goldman, HSBC, and others excited is the idea that China's financial system, long one of the most dysfunctional anywhere, is finally getting fixed. If that happens, it could blossom into one of the world's biggest profit machines as banks make lucrative loans, local bourses take off, a bond market develops, and more consumers learn the joys of credit cards, mortgages, and personal finance. China, with more than $1.8 trillion in personal savings—and a savings rate of close to 50%—could become the financial market of the 21st century. Should that gamble prove worthy, China will become much more than a bonanza for American manufacturers that have transplanted themselves en masse to the mainland. It will be the must-go destination for America's most ambitious financial-services firms.

That's the hope, at least. At the moment, Beijing is still in a titanic struggle to reinvent its financial system in the face of considerable internal opposition. "The scale of what is happening has never been seen in the world," says U.S. Treasury Secretary John W. Snow, who was in China to meet with top finance officials in mid-October.

Beijing's grand plan: fix the main banks, inject foreign capital and expertise into the system, clean up the local bourses—and throw financial markets virtually c pletely open to outside competition by 6, 2006. The government has already bilized the four biggest banks with $ billion in capital infusions. That cash helped them wipe almost half a trillion lars in bad loans off their books. Now Big Four are making big profits, and deposits are tumbling in by the billion

HELP WITH TECH

THE QUESTION FOR U.S. banks is ho play this opportunity. BofA is opting fo local-partner strategy. Although it wil only one seat on the Construction B board, BofA plans to send in a SWAT t of some 50 managers to help implen best practices in a Chinese context. B officials declined to comment during "quiet period" ahead of the CCB list But if everything goes according to p BofA could exercise an option to raise stake to 19.9% by March, 2011.

Executives at BofA will train their cal partners in such basics as due gence on potential borrowers and f tuning loans to reflect borrowing c and client risk. CCB also despera needs help in corporate governance information technology.

How U.S. Banks are playing the China Card

JUNIOR PARTNER Bank of America has a minority stake in giant China Construction Bank and a chance to build its Chinese partner's capability in risk management, mortgages, and more. BofA gets board seat, too. But the Chinese are in the driver's seat. American Express and Goldman Sachs are interested in taking a similar approach.

CONTROLLING PLAYER Private-equity firm Newbridge Capital has government approval to effectively run Shenzhen Development Bank. GE Capital may invest, too. Newbridge has a chance to reinvent the bank and cash out at an enormous premium.

GREENFIELD OPTION Citigroup has a minority position in a small regional bank. But it hopes to develop its own complete branch network once the market is fully open to foreign players in 2006.

Data: BW, company r

What's in it for BofA? It's buying into a ık with a huge footprint and millions ɔotential customers for Bank of Amer- products and services. CCB already ıtrols loans valued at about $293 bil- n, or 12% of the industry total. The nk enjoys dominant market positions home loans (23.1%) and bank credit ds (18.7%). Chairman Guo says he has uge edge with blue-chip companies in wth industries such as power and tele- n. "CCB is an attractive investment op- tunity," says Guo.

Minority partnership isn't the only way go. Some U.S. outfits are negotiating right control of their partners. Private- ity group Newbridge Capital Group, ed in Fort Worth, effectively has a con- lling 18% stake in Shenzhen Develop- nt Bank and has installed a Bankers st veteran, Frank Newman, as chair- n. Newman has already made enough gress in fixing the bank that GE Capi- will probably soon take a 7% position. Citigroup, meanwhile, is hedging its s. It plans to expand its existing main- d retail network while keeping 4.6% of anghai Pudong Development Bank. alysts say Citi officials are actively uting for branch locations in urban ar- throughout China. "They are on the ɔund and ready to open branches when law changes in 2006," says analyst An- w Collins at Piper Jaffray & Co.

All these strategies entail big risks. fA, for example, is getting in bed with a ık that earned $6 billion last year, re- ts that were audited by KPMG. Nice. t the CCB offering prospectus also re- ls more than 100 cases of theft and bezzlement at the bank from 2002 to 04. The company remains dependent real estate loans, a risky category in go China. And with the national gov- ment keeping a 62.5% stake in the ık, Bank of America won't be able to ɔose its will on management.

Beijing may not make all the moves the S. wants in opening its financial sector spite a weeklong visit by Snow and Se- ities & Exchange Commission Chair- n Christopher Cox. Cox says that in etings with top regulators, the talk was gradual steps, not quick leaps. As Cox ts it: "If you take nothing but half-steps reach the wall, will you ever reach it?" ina has refused, for example, to lift its % cap on total equity held by outsiders its banks. That's enough to give in- tors pause—but probably not enough to ke them stop. The next wave of China er is set to hit. ■

–With Frederik Balfour in Shanghai and Chester Dawson in New York

MONEY FLOWS

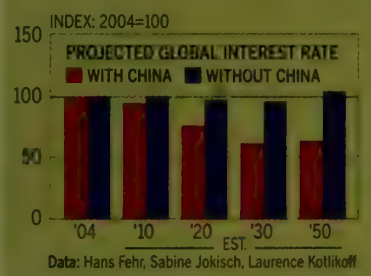
It's the Piggy Bank To the World

If you made a list of respected pessimistic economists, Laurence J. Kotlikoff of Boston University would be near the top. For years he has warned that an aging population and overspending on entitlements were going to send budget deficits and tax rates skyrocketing, driving up interest rates and creating a capital shortage for decades. In 2004, Kotlikoff wrote: "We are heading into one God-awful fiscal storm, the full dimensions of which are hard to fathom."

But now this notable gloom-and-doom type has turned a bit cheerier. The reason: the China effect. In a new paper, Kotlikoff and his two German co-authors, Hans Fehr and Sabine Jokisch, find that a flood of Chinese savings over the next 40 years could turn the anticipated capital shortages into capital gluts instead—not just in the U.S, but in Europe and Japan as well. According to their calculations, the potential impact of China is so large that global interest rates could drop by as much as a third by 2050, even with all the expected government borrowing. Those lower rates, in turn, could finance more business investment, boost productivity, and raise national incomes across the developed world. "It's potential good news in a very bleak fiscal picture," says Kotlikoff.

CHINA EFFECT

A flood of Chinese savings could reduce global interest rates



Data: Hans Fehr, Sabine Jokisch, Laurence Kotlikoff

Their study, entitled *Will China Eat Our Lunch or Take Us Out to Dinner?*, represents a serious attempt to project China's long-term effect on the global economy. Kotlikoff's expertise is in long-run projections as one of the creators of "generational accounting," a way of measuring how tax and spending policies affect different age groups over long periods of time.

For the China study, the three economists accounted for a host of variables, including the aging of the Chinese, European, Japanese, and American populations, shifts in savings behavior, immigration, and the future of health-care costs. In the end, it turned out that even if Chinese growth slows, it still could generate enough savings to hold down global interest rates, at least through the middle of the century.

Surprisingly, the study also predicts that the China effect could boost average wages in developed countries by more than 15% by 2030. The reason? Lower interest rates will make it easier for U.S., European, and Japanese companies to invest in productivity-enhancing equipment—and at least some of the benefits will be won by labor. At the same time, real wages will rise fast enough in China to greatly close the gap with the developed countries. That will make the competitive pressure on workers less intense.

True, any economic model that projects out 50 years or more must be taken with a healthy dose of skepticism. Nevertheless, the potential size of the China effect could help justify the willingness of foreign investors to take the risk of buying into Chinese state-owned banks. If Kotlikoff and his two co-authors are right, China will be the source of savings for the world for a long time to come.

–By Michael Mandel in New York

BORROWING

HEDGES: THE NEW CORPORATE ATMs

Funds and other institutional investors are lending as banks get pickier

AS COMMERCIAL BANKS back away from making corporate loans, a new breed of lender is stepping in: Hedge funds are providing hundreds of millions of dollars to companies whose shaky credit disqualifies them for prime bank loans or whose needs are too puny to attract big commercial bankers. But with the new source of capital come new dangers, including the possibility that hedge funds will make risky loans and exploit information gained as lenders to benefit their trading gambits.

The uncertainties haven't stopped companies from lining up at hedge fund loan windows. SLS International Inc., a small Ozark (Mo.) maker of audio speakers for musicians and movie theaters, struck a distribution deal in March with Wal-Mart Stores Inc. But to take advantage of this opportunity to break into the consumer market, SLS needed cash to build a new factory in the U.S. and pay for supplies and production overseas. Big banks "wouldn't have provided the amount of capital that we needed," says SLS President Steven Lamar. "There's only so much risk they'd take."

QUICKER ON THE DRAW

ENTER HEDGE FUND manager Lawrence Goldfarb of BayStar Capital in Larkspur, Calif., which loaned the company $8 million out of $15 million raised from several funds. Hedge funds, which are largely unregulated pools of private capital, "are able to respond quicker to the needs of public companies and with more creative terms," says Goldfarb. "And they have a lot of cash to put to work."

Funds like Goldfarb's are filling a vacuum created by consolidation in the bank-

ing business. As commercial and inve ment banks have combined, the result behemoths have favored more lucra activities, such as advising on merg and acquisitions, and avoided comm cial lending, which sometimes leads losses. The banking giants still m loans to their biggest and best custom but increasingly avoid smaller and risk deals. Bank of America Corp. slashed corporate loan portfolio from $110 bill in 2000 to $34 billion in 2004. For c tain borrowers, hedge funds and other vestment outfits not normally thought as lenders are filling the gap. The Car

ROBERT NEUBECKER

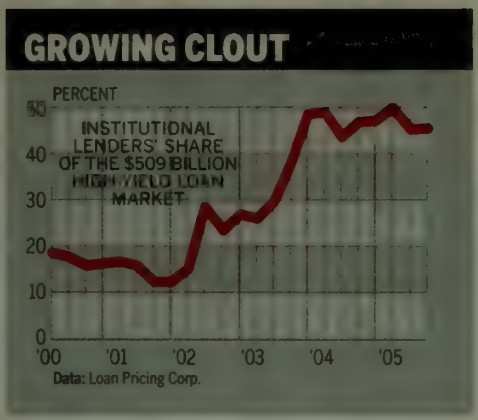
p, a prominent buyout firm that has ously invested in high-yield corpo- debt, announced recently that it d start making loans, too.

dge funds and other institutional tors now provide almost 50% of $509 billion market for riskier, interest rate loans to corporations. s up from less than 20% in 2000, ding to Loan Pricing Corp., a unit uters.

e potential peril is that hedge funds ry to lure borrowers with relatively ates, easy terms, and lax attention to tworthiness. With barely any gov- ent oversight, fund managers inex- nced in lending may misjudge their wers. As a result, hedge fund in- rs ranging from public pension s to wealthy individuals could face losses. "You cannot have ever-riski- ansactions and not ultimately have cussions," says Neal Schweitzer, r vice-president of Moody's In- rs Service Corporate Finance Group. all conditions in the high-yield debt l are already growing more worri- . In the third quarter, only 41% of the gs changes Moody's issued for high- paper were upgrades—down from in the second quarter. Default rates cking up.

DING CONFLICTS?

DING MAY ALSO create conflicts with e funds' trading of stocks and bonds. e traditional commercial banks,



which promise to protect their clients' interests, hedge funds are notorious for sometimes betting against the very companies whose securities they hold. Funds that buy the bonds of a struggling company—a bet that the issuer will recover—commonly hedge by simultaneously shorting the company's stock, an investment that pays off if the share price falls. In Britain, the Financial Services Authority—the equivalent of the U.S. Securities & Exchange Commission—is examining whether hedge funds are illegally using sensitive private information that they gain as lenders when they trade companies' bonds and stocks.

Funds that lend and buy loans could get in trouble

For now, though, corporate borrowers couldn't be happier. They find that hedge funds and similar institutional investment firms are willing to cut deals quickly, without the red tape big banks require to meet regulators' demands. And the difference in interest rates is surprisingly slight. Prime loans from banks generally run 5% to 6%. Hedge funds elbowing into the corporate loan business are offering 6% to 8%, according to people in the industry. The list of companies turning to alternative lenders includes U-Haul International's parent, AMERCO, Krispy Kreme, Aloha Airlines, textile manufacturer Dan River, and Salton Inc., which makes George Foreman grills.

IGN Entertainment Inc., an Internet publishing company based in Brisbane, Calif., obtained $35.5 million to pay for acquisitions from GoldenTree Asset Management, a New York firm that runs a hedge fund as well as a lending unit. "A large bank is just not going to marshal its resources for a company that needs $30 million," says GoldenTree partner Jonathan Ezrow. The firm got its money back early when News Corp. bought IGN for $650 million this month.

Many loans made by new-breed lenders are quickly sold off, and hedge-fund money is fueling more intense trading in this secondary market. Trading of high-yield loans has increased from roughly $112 billion in 2002 to about $163 billion in the last 12 months, according to Loan Pricing. Loan prices have skyrocketed as new money has poured into the market. Nearly 50% of high-yield loans are priced above their face value, up from less than 2% in 2003.

In addition to the fear that hedge funds will be tempted to make reckless loans that could go sour when the economy slows, some observers worry that eventually the funds will simply lose interest in lending and buying loans. "Let's face it: The economy will change someday, and all these hedge funds will decide that there is someplace else they would rather be," says Darvin Pierce, executive director of Van Kampen Senior Loan Group, which manages about $6 billion in prime bank loan funds for individual investors.

Hedge fund managers counter that they aren't fair-weather lenders. One fund executive, who asked to remain anonymous, said: "We do an enormous amount of analysis very fast and provide these companies with rescue financing that allows them to preserve value in their businesses."

Then there are others who say hedge funds make the economy more resilient. Federal Reserve Chairman Alan Greenspan is a fan of mechanisms like loan trading that spread credit risks rather than leave banks carrying the entire burden. Glenn Yago, director of capital studies at the Milken Institute, a Santa Monica (Calif.) think tank, notes that secondary markets have made credit crunches rare. "We've absorbed a lot of disruptive credit events over the past few years—the Asian crisis, the Russian default, the NASDAQ crisis, September 11," says Yago. The secondary markets won't lack for loans anytime soon, as companies hard up for cash continue digging into hedge funds' deep pockets. ■

–By Mara Der Hovanesian in New York

CATERPILLAR Buyers of heavy gear would get faster write-offs

THE WHITE HOUSE

AN UGLY SPLIT OVER BUSINESS TAXES

A Bush tax-reform commission could create big winners and bitter losers

PRESIDENT GEORGE W. Bush hopes to use tax reform to rally his base, revive his second term, and bury the idea that he's a lame duck. But if the White House follows the map drawn by Bush's tax-overhaul commission, the President could alienate everyone from corporate chieftains to real estate agents and suburban bankers.

The panel—set to report on Nov. 1—will propose huge potential changes in the corporate income tax as well as the tax treatment of mortgage interest, health care, and retirement savings. That will cleave the business community down the middle, dividing CEOs into happy winners and bitter losers. "We're looking at corporate cannibalism," says a GOP business lobbyist. "This could get real ugly."

In theory, business likes lower tax rates and a simpler code—key goals for the reform panel chaired by former Senators Connie Mack (R-Fla.) and John B. Breaux (D-La.). And high-paid executives will be glad to see the hated Alternative Minimum Tax disappear from their personal 1040 forms. But in practice every industry thrives on specific tax breaks, and corporate lobbyists get paid to defend those sacred cows, not principles of tax theory. Layer on the vast uncertainties of a tax transition, which could wipe out trillions in tax benefits that companies have stored on their books, and business may choose to just say no to any Bush tax plan.

Here are some of the flashpoints:

» Either of the panel's two options—a streamlined income tax or a consumption tax designed to promote savings—would hit housing hard. Today homeowners use the mortgage-interest deduction to offset 35% of their interest for mortgages up to $1 million. The proposal would let them offset only 15%, and only for mortgages up to $312,000. Mortgage bankers, real estate agents, and builders of upper-bracket homes are rallying to defend the deduction.

» Measures to boost savings via larger, streamlined tax-free accounts threaten the life insurance biz, which sells whole-life and annuity policies as tax-favored savings vehicles. Bigger individual retirement accounts and 401(k)s would undercut those policies' steep fees. Insurers plan to fight back by arguing that their products promote badly needed long-term savings. "Not all savings are created equal," says an industry spokesman.

» The panel's consumption-tax option would grant heavy industry its cherished goal—the ability to write off all capital equipment in the year that it's purchased. But even that benefit comes with a big trade-off: Businesses wouldn't be allowed to deduct interest expenses. So big borrowers might be net losers—particularly those in the service and technology industries that run more on brainpower than on heavy equipment and thus don't gain from immediate expensing.

» In the transition to a new system, companies could lose some of the fortune in unused tax depreciation they're carrying—a step that could force a major hit to earnings. Manufacturers, retailers, and service companies, whose books reflect years of carefully crafted tax planning, will fight to defend their breaks against a radically new tax regime.

> "We're looking at corporate cannibalism," says a GOP lobbyist

The details of the commission's two plans could change before Nov. 1, and the Treasury Dept. is likely to sit on the proposals for months. Early next year the White House will decide which ideas to adopt, if any, for a tax overhaul plan Bush can embrace. Administration insiders are being extremely tight-lipped about their intentions. For now, says R. Bruce Josten, executive vice-president at the U.S. Chamber of Commerce, "this is a float-the-trial-balloon game."

It sure has gotten business' attention. Some of the industries with the most to lose were key supporters of Bush's big first-term tax victories. But those were tax cuts that gave everyone something. Tax reform, by contrast, will be a zero-sum game. Should Bush decide to play that game, he could find many of his usual business allies staring him down from the other side of the field. ■

–By Howard Gleckman in Washington

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INVESTORS

KERKORIAN AT THE GATES

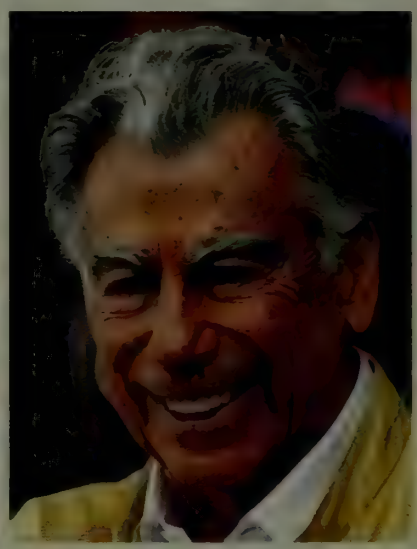
Why GM's deal on health costs won't halt his quest to make it restructure

WHEN GENERAL Motors Corp. detailed elements of its restructuring plan on Oct. 17, few were watching as closely as investor Kirk Kerkorian. Ever since the corporate agitator went public with his plans to buy nearly 10% of GM stock in May, investors have welcomed his presence as a powerful agent for change at a company that appears to be moving too slowly to fix its myriad problems. They also viewed his September filing, which expressed interest in a board seat, as a sign that he planned to become decidedly more activist.

Now, thanks to a major concession from the United Auto Workers, GM Chairman and Chief Executive G. Richard Wagoner Jr. has come up with $1 billion a year in health-care savings. But that alone won't keep Kerkorian at bay. Analysts and sources close to his Tracinda Corp. investment firm say he will want to see a more detailed restructuring plan, which Wagoner won't divulge until December. And even then, the billionaire and his lieutenants may push for a stronger course of action if they don't believe GM will become profitable in the medium term. "I don't think this changes Kerkorian's game plan," says Joseph S. Phillippi, president of consulting firm AutoTrends and a former Wall Street analyst. "GM has a lot more to do."

The question now is how Kerkorian will exert pressure on GM. He could demand a board seat and try to put his imprint on GM's restructuring plan. Indeed, ever since Kerkorian began amassing stock in May, speculation has been rife that the 87-year-old raider would force GM to make his trusted deputy, former Chrysler Corp. and IBM Chief Financial Officer Jerome B. York, a director.

But grabbing a board seat poses dangers. For one thing, Kerkorian would be exposed to shareholder lawsuits if his actions were seen as harmful to GM. "In the post-Enron era, being a director comes with a certain amount of risk," says Robert J. Guiffra Jr., a partner with Sullivan & Cromwell. "He could be viewed as a part of the problem, not the solution."



PRESSURE Kerkorian (right) might strong-arm Wagoner into buying back shares

Kerkorian could increase his stake in GM and win over other investors

What's more, taking a seat on the board would entangle Kerkorian in the company's restrictions on insider trades. GM's rules prohibit board members from selling stock during their service except when they are exercising options. And, with York on the board, Kerkorian also would have to adhere to U.S. securities laws that state he may buy or sell only during certain periods. All of the above would make it tougher for Kerkorian liquidate his investment in the auto m er. "You have a much greater range of tion if you're an outsider," says Guiffr

MOUNTAIN OF CASH

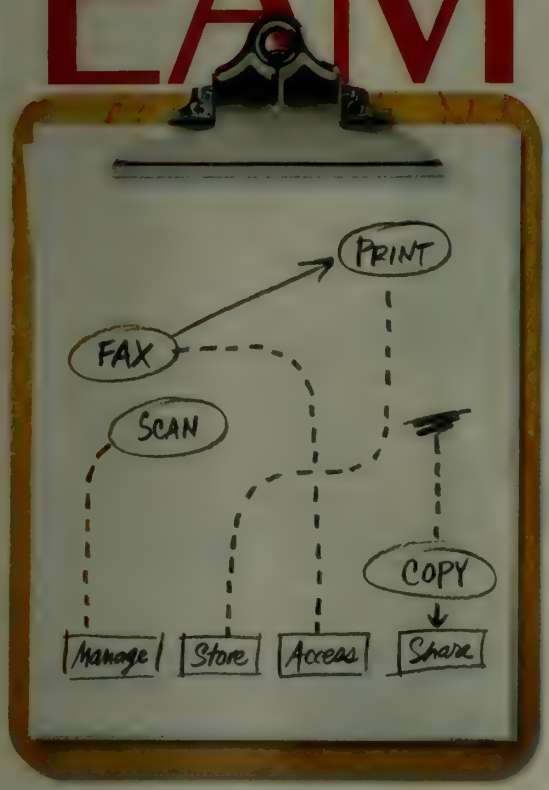
SO WHAT MIGHT Kerkorian do instead using the board to push his agenda? quiring more stock might get him the sults he wants faster than waiting f wholesale restructuring to material That in turn would give him more vot shares; such clout could convince big shareholders such as Capital Research Management and Southeastern Capita join the Kerkorian camp, says Phillip Those three shareholders would hav 32% combined stake. "These invest bought stock based on a belief that a t around is in the offing," Phillippi says something doesn't happen, I could some siding with Kerkorian."

Then, presumably, Kerkorian wo pressure management into using mountain of cash to fund a major structuring, buy back stock, or pay to go away. After all, despite its pr lems, GM has $19 billion in cash. A that hoard could get a lot bigger if W oner sells a majority stake in the hug profitable General Motors Acceptan Corp. lending arm as he said he mi on Oct. 17. Offloading 60% of GM would bring in about $12 billion in ca says Sanford C. Bernstein & Co. anal Brian Johnson.

A Kerkorian proxy could still end up GM's board. That would be more likel Wagoner's restructuring steps—clos plants, reviving the vehicle lineup, wi ning more union concessions—don't as far as Kerkorian is expecting. If W oner doesn't deliver a credible plan by end of the year, look out. ■

–By David Welch in Det

TEAM PLAYER



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MOBILE SOCIETY

'WORKING LATE' WON'T WORK ANYMORE

New services can track you–or your loved ones–by cell phone

IT SOUNDED TOO ORWELLIAN ever to succeed. In 2000, Korean cellular carrier SK Telecom introduced a service called "find friends" that lets others follow your every move, using a signal beamed from your handset. At the time, many wondered whether anyone would consent to such tracking.

But five years—and countless terrorist attacks, earthquakes, and other calamities—later, the service is taking off. "I used to be worried when my boyfriend didn't answer my calls," says Shim You Sun, a 25-year-old accountant who pays 11¢ each time she checks up on him. "Now I can rest assured that he is at work or busy attending a seminar."

She's one of more than 4 million Koreans who have signed up for various services using technology that can determine a cellular subscriber's location. One, costing $3 per month, will send a message with your coordinates to friends and family periodically while you're traveling. Another will automatically dispatch a text message to friends who get within a block or so of each other as they move around town. Yet another, costing 29¢ a day, will send a message if a person isn't at a specified place at a certain time and then allows the tracker to see the person's movements over the previous five hours. And 20,000 parents pay $10 per month for alerts if their children stray from the route between school and home. The Korea Association of Information & Telecommunication reckons such services are growing by 74% annually, with revenues expected to triple in 2007, to $1.54 billion, from $500 million last year.

PROFITABLE PURSUIT

In Korea, the future may have arrived early. Elsewhere it might take a while before consumers warm up to the idea of cell-phone tracking. In the U.S., a company called Teen Arrive Alive offers parents a $20-a-month tracking service for their teens. But to date the company has sold the service to only one cell-phone carrier, Nextel.

Others are having a tough time, too. Cingular phased out a tracking service offered by AT&T Wireless when the two carriers merged last y[illegible] Small wonder: L[illegible] than 20% of Am[illegible] cans are willing [illegible] pay for such info, [illegible] market watcher Jupiter Research.

In other countries, consumers [illegible] proving more open to cellular tracking. [illegible] Britain, The Carphone Warehouse off[illegible] mapAmobile, a $52-a-year service t[illegible] lets parents track their cell-toting k[illegible] And in Japan, subscribers can sign up [illegible] text messages advertising bargains at [illegible] partment stores as they pass by.

Korea, though, is clearly at the fo[illegible] front—and not just for consume[illegible] Hwang Yoon, who runs a call center [illegible] 1,500 taxi drivers, uses a service t[illegible] broadcasts text messages to cabdriv[illegible] within a one-, two-, or three-kilome[illegible] radius of a fare's location. The first d[illegible] er who responds—by pushing a but[illegible] on the phone—gets the job. "This te[illegible] nology is an excellent and cheap fit [illegible] us," says Hwang. Sales of business-[illegible] lated tracking services in Korea are [illegible] pected to jump more than fivefold t[illegible] year, to $248 million, from $43 milli[illegible] last year.

KEEPING IT PRIVATE

EVEN SO, THE *1984* feel of some of th[illegible] services has prompted Seoul to step in [illegible] ensure customers' privacy. In Decemb[illegible] the National Assembly approved a l[illegible] that requires a government license for [illegible] companies gathering such location inf[illegible] mation. Companies with licenses can o[illegible] share that information with people des[illegible] nated by those being tracked, and th[illegible] individuals are ensured access to detail[illegible] records of all requests for tracking. Th[illegible] can also opt out of the service any time [illegible] decide to slip aw[illegible] temporarily by sele[illegible] ing a "hide" option [illegible] their phones. "We s[illegible] lots of potential in [illegible] cation-based servi[illegible] and took steps to p[illegible] tect individual rig[illegible] as there were ling[illegible] ing concerns over p[illegible] vacy," says Pan Sa[illegible] Kwon, a deputy dir[illegible] tor at the Minis[illegible] of Information [illegible] Communication.

It may seem creepy to some, but [illegible] many Koreans the increased security [illegible] letting others know where you are [illegible] worth the tradeoff. ■

–By Moon Ihlwan in Seoul, w[illegible] Andy Reinhardt in P[illegible]

In the 1930's, trains were the QUICKEST way to tr
Of course, NOTHING *could keep pace with news th*

THE GLENLIVET

was the first SINGLE MALT *to arrive in* AMERICA

The famed PULLMAN *cars did not run on* COAL *alone, they also had the force of* THE GLENLIVET *DRIVING them across the country.*

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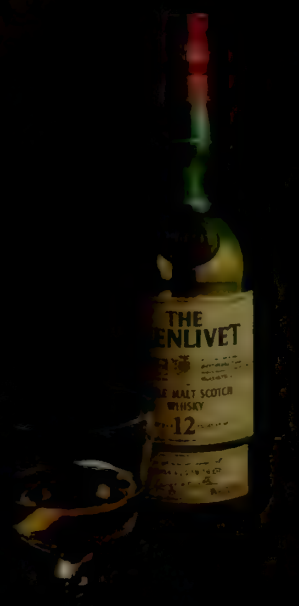


THE SINGLE MALT THAT STARTED IT ALL

EDITED BY ANNE NEWMAN

HEADLINER

MIKE S. ZAFIROVSKI

HANDYMAN'S SPECIAL

Former Motorola Chief Operating Officer Mike Zafirovski has long wanted to run his own company—and now his wish has come true. On Oct. 17, Zafirovski, 51, was named CEO of beleaguered telecom equipment maker Nortel Networks.

Zafirovski aims to return Nortel to its dot-com-era glory. That's a tall order. He takes over on Nov. 15 from William Owens, who struggled to steady Nortel as it reeled from an accounting scandal that led to years of financial restatements and the 2004 ouster of 10 executives, including then-CEO Frank Dunn. The crisis diverted resources and spooked some customers. Now Zafirovski is out to regain confidence and boost profits. He plans to cut procurement and other costs but may have to ax jobs and lagging businesses, such as the optical unit. And he has the tough task of finding new markets like next-generation wireless networks. Welcome to the CEO's seat, Mike.

–Roger O. Crockett

PUBLISHERS VS. GOOGLE

Google's efforts to extend its tentacles into offline content are coming under increasing fire. Five major publishers—*BusinessWeek* owner **The McGraw-Hill Companies**, **John Wiley & Sons**, **Pearson Education**, **Penguin Group (USA)**, and **Simon & Schuster**—sued Google on Oct. 19 seeking to block the Internet titan's efforts to scan copyrighted works without their consent. The Authors Guild filed a similar suit in September. The Google Print initiative aims to scan and digitize millions of books to make them searchable on the Net. Google insists it isn't violating copyright law because it shows only snippets of works. And it argues that helping more people find texts will boost sales for copyright holders. Publishers, however, argue Google is trying to make millions by misusing copyrighted materials without their permission.

IVY-COVERED INVESTOR

Harvard University tapped **Pacific Investment Management** managing director Mohamed El-Erian, 47, to replace its high-profile and highly paid money manager, Jack Meyer. El-Erian, who oversees more than $28 billion in emerging-markets debt, will begin managing Harvard's $25.9 billion endowment early next year. Meyer led Harvard Management to chart-topping returns, but critics blasted his salary, more than $7 million in 2004. Harvard wouldn't say what it's paying El-Erian, a close colleague of PIMCO bond chief William Gross. Meyer plans to open a hedge fund—and already has lined up Harvard as an investor.

BIOTECH BONANZA

Biotech is giving Wall Street a shot in the arm. On Oct. 19, **Amgen** said its third-quarter profits quadrupled, to $967 million, from a year earlier, when the Thousand Oaks (Calif.) company was bogged down with acquisition costs. A 38% surge in sales of its anemia drug helped push up overall sales 19%, to $3 billion. And **Genzyme** of Cambridge, Mass., said on Oct. 18 that third-quarter profits rose 38%, to $160.5 million, before amortization and one-time charges. Sales rose 24%, to $708.1 million, because of high demand for its drugs to treat kidney disease, knee pain, and Fabry disease, a genetic disorder.

THE BIG BANKS RAKE IT IN

The Federal Reserve's march to raise interest rates was supposed to hammer profits for banks by squeezing their margins—the gap between borrowing costs and the rate at which banks could invest or lend funds. Apparently, the banks never got that memo: On Oct. 19, **JPMorgan Chase** said third-quarter profits rose 78%, due largely to a surge in trading and investment banking fees. And **Merrill Lynch** said profits for the sa quarter rose 49%, to $1.4 billion, as underwriting an trading revenues soared. Among commercial banks without large trading or M desks, **Bank of America** reported a 10% rise in thir quarter earnings on higher service fees and a rebound mortgage banking income

ET CETERA...

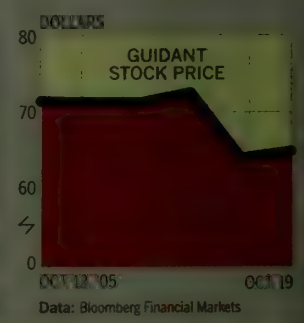
>> The **Chicago Board of Tra** raised $172 million in an O 18 initial public offering.

>> **Cisco Systems** said it will invest $1 billion in India ov the next three years.

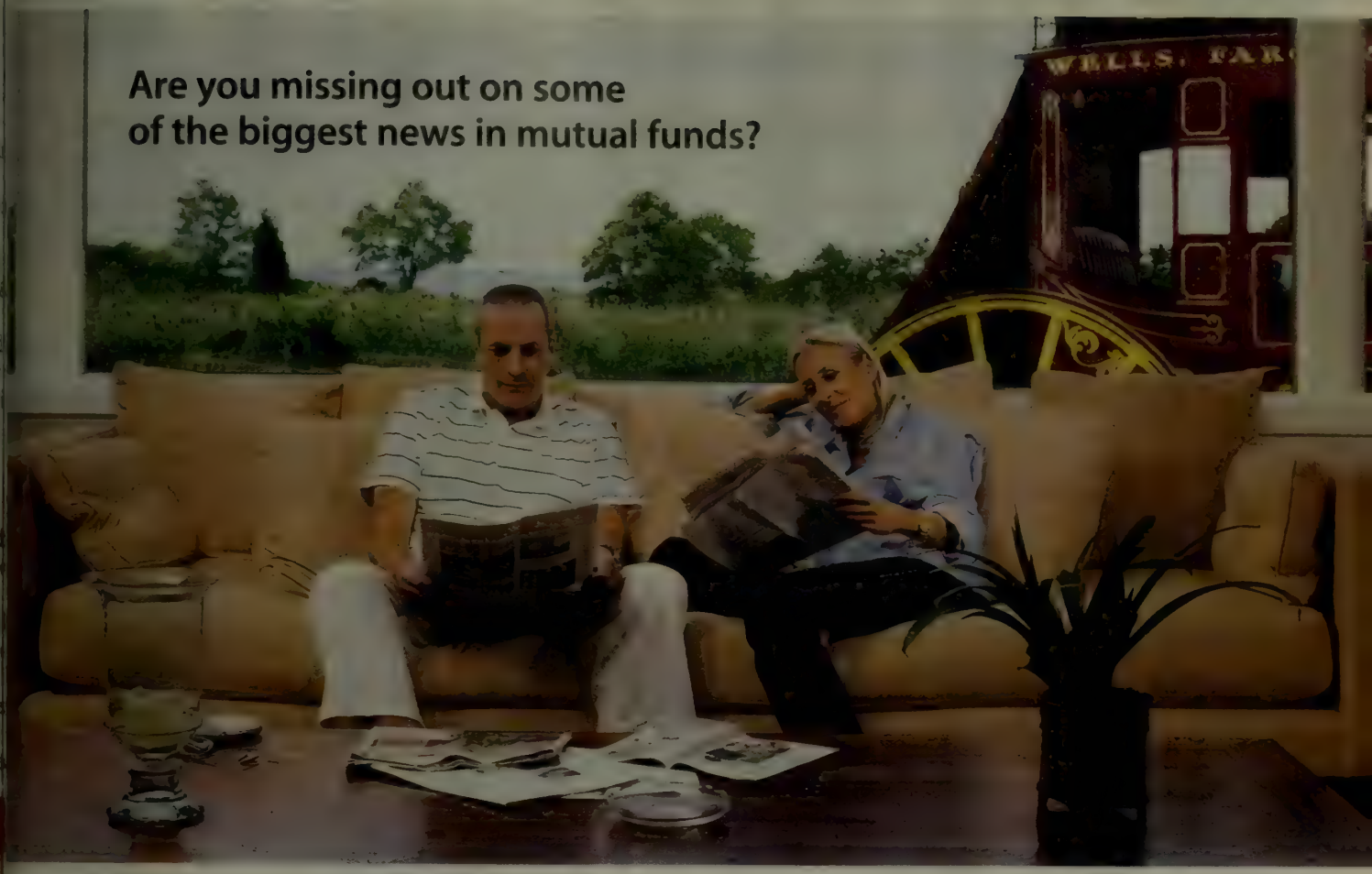
>> **JPMorgan** President Jam Dimon will become CEO at yearend, earlier than expect

CLOSING BELL

Guidant shares sank 11%, to $64.10, on Oct. 18 after Johnson & Johnson warned it may lower its $76-a-share bid in light of product recalls b the maker of implantable defibrillators and other devices. J&J agreed in late 2004 to buy Guidant for $25.4 billion in cash



WELLS FARGO | ADVANTAGE FUNDS



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The Fairness in Asbestos Injury Resolution (FAIR) Act purports to solve America's asbestos litigation crisis. In reality, it makes matters worse while creating an entire class of new victims – hundreds of U.S. companies unknowingly required to make massive mandatory payments to the $140 billion Trust Fund. Even more troubling, recent Congressional and independent economic analyses confirm the hidden truth about the FAIR Act Trust Fund:

- The "revenue stream that would be generated by the legislation is highly uncertain" and "it may or may not have adequate resources to pay all claims." (Congressional Budget Office, August 25, 2005)
- The Trust Fund "is not financially viable," will be severely underfunded from the start by at least $160 billion, and will go broke in just three years – leaving many claims uncompensated. (Bates White LLC, Analysis of S. 852; September 19, 2005)

The Coalition for Asbestos Reform, a group that includes small and medium sized businesses, is committed to the fair resolution of the asbestos litigation crisis.

Why the FAIR Act is Unfair: Devastating for Most Companies – A Windfall for a Few

The funding for the FAIR Act would come from mandatory assessments on hundreds of companies that are neither aware nor capable of meeting onerous payment obligations, many of whom have substantial insurance assets that would be rendered void by the bill. This same payment structure also assures that certain bankrupt businesses with the greatest liability, together with a handful of Fortune 100 companies, receive a tremendous, ill-deserved windfall.

Even though the FAIR Act would force businesses and insurers to finance $140 billion in assessments, the Congressional Budget Office warned that the Trust Fund would still need to borrow more than $8 billion from federal coffers. And in the process of creating this massive federal entitlement program that is all but certain to become insolvent, the Congressional Budget Office noted that the "continuing drain on [participating companies'] resources could lead to more bankruptcies and even higher levies on remaining firms."

With more and more states enacting meaningful tort reform measures, the FAIR Act eviscerates these positive state efforts and replaces them with a federally-managed trust fund with a speculative funding stream that poses financial risks to the economy that our nation can ill afford. Congress' own budget analysts, together with independent and non-partisan experts, confirm the reality of the Senate bill.....

The FAIR Act: An Underfunded, Unfair Bailout for a Few Big Companies – Paid for By You and Your Company

To find out how your company will be affected by the FAIR Act,
visit the Coalition for Asbestos Reform's website at **www.asbestosreform.org**.

The Coalition for Asbestos Reform is a group that includes small and medium sized businesses committed to the fair resolution of the asbestos litigation crisis.

ITED BY RICHARD S. DUNHAM

Congress Gets Serious About a Pandemic

HAT'S SCARIER IN WASHINGTON, the prospect of a flu virus that uld kill millions or the possibility that voters will toss out any litician who fails to prepare the nation for such a disaster? A ndemic could be a true global catastrophe, of course. But ong the Potomac the second threat is also very real. That's a big son why both the White House and ngress are rushing to boost America's pacity to produce vaccines and drugs inst flu and other diseases (page 102).

On Oct. 18 the Senate Health, Education, bor & Pensions Committee hurriedly sed a bill that would offer vaccine mak- new liability protections and incentives research. And the Administration is out to issue a flu pandemic plan expected be extremely aggressive.

here is a sense of urgency on h sides of Pennsylvania Av- e," says Senate Budget mmittee Chairman Judd egg (R-N.H.).

n a town where politics is g, it's easy to be cynical out all this action. "There is t of posturing so that peo- can say they've done some- ng in case the worst hap- ns," says one source olved in the negotiations. ndits also see careful posi- ning by White House hope- s. In early October, for in- nce, Senators Hillary nton (D-N.Y.) and Pat berts (R-Kan.) introduced a that offered, in addition to arantees of a market for vaccines, liabil- protections for manufacturers of pan- nic flu vaccines. That wins Clinton ku- s on a pet issue—health care. But it also ps position her as a sensible centrist by llenging a Democratic interest group: l lawyers. Says John Clerici, a partner at Kenna Long & Aldridge in Washington: is courageous because she is taking on a constituency."

Yet even to jaded Washingtonians, it's r that the government needs to do more n posture. In 2004, Congress approved ject BioShield, a plan that would spend $5.6 billion over 10 years to jump-start production of vaccines and drugs to counter bioterror threats. But few companies have responded. "The current state of affairs is very grim for private sector engagement in vaccines and drugs," says Brad Smith, an associate at the University of Pittsburgh's Center for Biosecurity. "There is nothing in the pipeline." Last year companies couldn't even make enough vaccine for regular flu.

BIRD FLU
A rush to spur production of vaccines

That prompted Senators Gregg, Richard Burr (R-N.C.), and others to push for fixes, starting in early 2005. "We thought we had the problem moving in the right direction with BioShield," says Gregg. "It turns out we didn't. We needed a second run at it." Gregg's effort was going slowly, though, until Hurricanes Katrina and Rita showed how vulnerable the U.S. is to disasters—and until avian flu began to spread into Europe. "Those events sent a strong signal to Congress that catastrophic events can happen," says Smith.

Now, Washington is in a virtual sprint. Senator Tom Harkin (D-Iowa) on Sept. 29 put $3.9 billion into defense legislation to stockpile antiviral drugs. Clinton jumped in with her bill on Oct. 6. Burr offered his 11 days later. The most likely result: something like the Burr measure, which creates an agency modeled on the Defense Advanced Research Projects Agency to stimulate vaccine development, and also includes liability protection for manufacturers. The biggest hurdle: adjusting liability limits to keep enough Democrats on board. If Congress succeeds, it could better prepare the country—and help keep the current crop of lawmakers in office. ■

–By John Carey

CAPITAL INSIDER

BUSINESS BALKS AT TIGHTER BORDERS

BUSINESS GROUPS are increasingly dismayed at the tough tone of the immigration debate in Washington. That's why they're straight-arming a group allied with **President Bush.** The group, **Americans for Border & Economic Security,** was set up last summer at the urging of White House political guru **Karl Rove.** Headed by ex-Republican National Committee Chair **Ed Gillespie,** former Representative **Cal Dooley** (D-Calif.), and former House Majority Leader **Dick Armey** (R-Tex.), the organization had intended to raise a $3 million war chest, mainly from Big Business and service-sector employers. The money was to pay for advertisements and lobbying to secure passage this fall of legislation that would grant illegals some form of amnesty and guest-worker status.

An effort to secure amnesty for illegal workers has fizzled

But White House plans remain sketchy, and business lobbyists are sitting on their wallets. Companies fear that the Bush Administration will embrace efforts by GOP hardliners to seal the southern border and toughen sanctions against employers who hire illegal immigrants. The group has raised just $300,000, mostly from the agriculture, resort, and retail industries. Bush got business even more worried on Oct. 18 when he signed a $32 billion Homeland Security Dept. spending bill: It emphasizes stricter enforcement at borders.

–By Paul Magnusson

GERMANY

ONE HAND ON TWO STEERING WHEELS

Porsche's bid to control VW—both its rival and its partner—opens a Pandora's box of governance issues

WHEN PORSCHE family scion Ferdinand K. Piëch stepped down as chief executive at Volkswagen in 2002, he was already dreaming of cruising around the world with his family on a new $15 million, 102-foot sailboat. But the 68-year-old engineer, now VW's non-executive chairman, has changed tack. Since launching Porsche's bid to become the main shareholder at Volkswagen with a target 20% stake, Piëch has put sailing plans on hold and become chief protagonist in a power struggle at VW.

Porsche's move to control VW has triggered a crisis in German corporate governance. Piëch and the Porsche family own 100% of the voting shares of Porsche. So the sports car maker's $4 billion investment in October to raise its VW stake to 18.5% (with the intention of reaching 20%) gives Piëch strong influence at VW, which is both partner and competitor to Porsche. Porsche has already announced it wants several VW board seats.

Investors, analysts, and some members of the VW supervisory board are crying foul over Piëch's conflict of interest, since he juggles ownership in Porsche with his role as VW chairman. VW board member Christian Wulff, representing the state of Lower Saxony where VW is based, quickly commissioned a report by JPMorgan Chase & Co., which recommended that neither Piëch nor Porsche managers sit on VW's board. Both Piëch and VW declined to comment.

Complicating the situation is the existing joint venture between Porsche and VW and the fact that VW's luxury-car unit, Audi, competes with Porsche. Many buyers of the hot Porsche Cayenne sport-utility vehicle, which starts at $41,000, are probably unaware that VW workers produce more than 85% of the wholesale value of every Cayenne and that Cayenne shares 65% of its parts and modules with VW's Touareg. The Cayenne body is built at VW's low-cost plant in Bratislava, where workers earn $250 a month.

PIECH

Porsche's investment in VW is likely to secure similar cooperation to build its new four-door sports coupe, the Porsche Panamera, expected to hit the market in 2009. Analysts and auto industry experts figure that without the VW investment, Porsche could have trouble finding future allies that would offer the same generous terms as in the past, since the benefits of such agreements seemed to have flowed disproportionately to Porsche.

EASY MONEY

PORSCHE, for example, put $420 million into developing the highly profitable Cayenne. "That's very, very little for a new car," says Ferdinand Dudenhöffer, director of the German Center for Automotive Research at the University of Gelsenkirchen. If Porsche had done it alone, he notes, it would have needed to invest between $1.2 billion and $1.8 billion. "There's no question, VW had all the risks and Porsche earned the greatest profits," says Dudenhöffer.

VW Chief Executive Bernd Pischetsrieder insists the Touareg

Close Ties

How Porsche's SUV joint venture with Volkswagen helped turbocharge profits

VW TOUAREG

PORSCHE CAYENNE

- Porsche's successful Cayenne SUV shares some 65% of its parts and modules with VW's Touareg
- Porsche outsourced much of the development and manufacturing to VW—paying a unit price for each Cayenne body produced in VW's low-wage Bratislava plant
- Analysts estimate that parts developed and made by Porsche, mainly the engine and the transmission, account for only 13% of the total wholesale value of a Cayenne
- Porsche requires VW cover the costs to fix quality problems that arise in manufacturing, minimizing its own risk and investment

Data: BusinessWeek

HOT PEPPER Turning out Cayennes in Leipzig

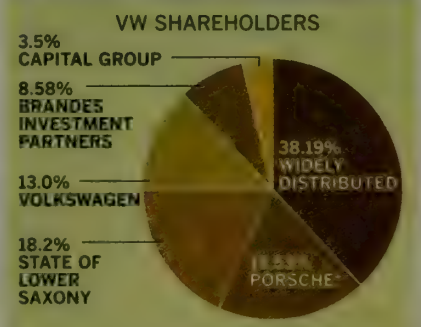
enne cooperation was a win-win proj- saying Volkswagen couldn't have ed a profit on the Touareg without its aboration with Porsche. He says VW's agement decisions will remain inde- dent of Porsche's influence, and has ured analysts and investors that the pany will set up a subcommittee to itor potential conflicts of interest and mer out a cooperation agreement will govern future joint ventures. "It solutely clear that... our model plan- g... must remain completely un- hed," he told analysts and journalists conference call on Oct. 11.

y snapping up nearly 20% of VW, h has effectively blocked any chance al might woo Volkswagen away from sche's side. Analysts say Porsche ed a possible tie-up between VW and mlerChrysler, which could have im- led Porsche's partnership with VW.

orsche's urgency to link up with kswagen exposed surprising cracks s own business model, analysts say. sche boasts engineering savvy, pow- l engines, and high margins, but its ce as a boutique auto maker out- rcing much of development and pro- tion now appears unsustainable. e, Chief Executive Wendelin Wiedek- engineered a decade of impressive wth by investing Porsche's capital ingly—mainly in the core 911 mod- and outsourcing most other manu- uring to third parties. But Porsche lacks depth in electronics, an increasingly vital element in luxury cars that requires billions in investments. Since Porsche doesn't produce in the volume needed to amortize hefty investments in electronics, development, and manufacturing, its future growth will depend on collaboration with a larger company that provides leverage and scale.

That larger partner is now Volkswagen. Besides worrying that VW may get the raw end of the deal in future projects, analysts also worry that VW premium brand Audi might be forced to delay or cancel certain models that challenge Porsche, such as the LeMans sport coupe. Audi insiders complain that the VW cooperation with Porsche on the Cayenne delayed by three years its introduction of the Q7 sport-utility vehicle, which will be launched in 2006, costing it lost profits and market share. Audi CEO Martin Winterkorn denies Piëch delayed the Q7 launch to benefit Porsche.

PORSCHE'S HOLD ON VW



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Data: *BusinessWeek*

Despite the investor concern, Piëch is likely to prevail in the battle for the board seats. All 10 labor representatives on Volkswagen's supervisory board support his bid to get two seats for Porsche managers. Labor controls 50% of the board and Piëch's vote makes a majority. Meanwhile, Wolfgang Bernhard, former Chrysler turnaround ace and now head of the VW brand, is struggling to restructure the carmaker, whose profits have plunged over the last three years. VW needs to slash 20,000 workers and spin off unprofitable components units, analysts say. Already skeptical that VW can meet its targets, they fear that Piëch, to get labor's backing for the board seats, could cut a deal with labor that ties Bernhard's hands.

Could the Porsche-VW alliance yet allow both partners to prosper? Porsche certainly wants to make a decent return on the $4 billion investment. If Piëch and Wiedeking don't slow Bernhard down, they could help forge a vibrant new legacy out of the two companies founded by Piëch's legendary grandfather. But first, investors' concerns about this deal must be laid to rest. ■

—By Gail Edmondson in Frankfurt

I checked my e-mail after I finished the conference call. I replied to all

AND

I adjusted my sunglasses. I took aim at the asphalt as I popped the clutch, ignoring the view in my rearview mirror.

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ran: So Much for Harmony at the Top

HEN IRAN ELECTED HARD-LINER Mahmoud Ahmadinejad as President last June, it looked as if Tehran might finally have a united conservative government capable of moving forward on everything from business projects to the diplomatic front. But just onths after Ahmadinejad took power, the conservatives are fighting among themselves, paralyzing the government. Executives, once eager to invest in Iran's vast oil and gas resources, are preparing for a long wait.

Business was worried about Ahmadinejad, the relatively unknown former mayor of Tehran, but there was an attractive side to him. At 49, he was youthful, enthusiastic, and untainted by a long history in Iran's army politics. Now his zeal and inexperience are proving liabilities. His provocative statements have worsened Iran's confrontation with the West over Tehran's nuclear program, scaring foreign investors.

Feeing funds

AT THE SAME TIME, the President's erratic domestic policies are spooking local investors. They're worried about Ahmadinejad's pop-up proposals for spending Iran's expected $35 billion or so in oil revenues this year, such as handing $1,100 to every newlywed couple. And Ahmadinejad has been tapping inexperienced unknowns for top positions. Parliament has rejected his first choice as Oil Minister, Ali Saeedlou, as lacking background in Iran's key industry. Iranians are shipping money to Dubai and dumping shares in the Tehran Stock Exchange, whose index is down 20% since the May campaign.

Ahmadinejad looked like the sort of President that Iran's top religious authority, Ali Khamenei, wanted. They come from the same ideological quadrant. But far from a love fest, Tehran is rife with rumors of angry phone calls from Khamenei to Ahmadinejad. In early October, Khamenei decreed that the Expediency Council, a powerful unelected body, would have overall supervision over the government. The move had two motives: to blunt Ahmadinejad's power and to boost the council's chairman, former President Hashemi Rafsanjani, whom Ahmadinejad defeated in the election. Rafsanjani has made clear his disdain for Ahmadinejad's approach. On Sept. 30, he warned Iran's nuclear negotiators that "you need diplomacy and not slogans."

Tensions may continue because the President comes from a different mold than Khamenei and Rafsanjani, elderly clerics who were associates of the late Ayatollah Ruholla Khomeini. Ahmadinejad hails from the Revolutionary Guards and other shock troops of the 1980 revolution. He is critical of the older generation for taking financial advantage of their proximity to power. But his anticorruption witch-hunts are making a shambles of government.

POWER PLAYS Ahmadinejad and Ali Khamenei are clearly at odds

So will Ahmadinejad's emergence be the event that leads to the regime's demise? "The Islamic Republic's survival instincts are very good," says Siamak Namazi, an Iranian consultant who is now a public policy scholar at Washington's Woodrow Wilson International Center. Instead, Khamenei will take on a bigger role. He is already running the nuclear portfolio and trying to avoid a showdown with the U.S. and Europe while not giving up Iran's nuclear ambitions. He may succeed because neither Russia nor China want U.N. sanctions on Iran. Still, Iran looks to be squandering a golden chance. Instead of cashing in on a propitious moment, it is barely skirting new disasters. ■

–By Stanley Reed in London, with Babak Pirouz in Tehran

WORLD WRAPUP

PAKISTAN: AFTER THE HIMALAYAS QUAKE

PAKISTAN IS still reeling from the earthquake that hit the Himalayas in early October. On Oct. 19, authorities said the death toll had risen to nearly 48,000, while 60,000 have been injured and 3 million left homeless in the Northwest Frontier Province and Kashmir. Despite the devastation, **President Pervez Musharraf** said on Oct. 18 that the area would be rebuilt for a total estimated cost of $5 billion. That could put construction, cement, and related industries "into high gear over the next 12 months," says Nadeem Naqvi, CEO of AKD Securities, a Karachi brokerage. Because the quake didn't hit industrial or agricultural centers, the economy is still expected to grow 7% this year.

The disaster may ease India-Pakistan tensions

Meanwhile, there are signs the disaster may help resolve the long-standing dispute over Kashmir, which has sparked three Indian-Pakistan wars. Despite continued violence, including the assassination of an Indian official in Kashmir on Oct. 18, contact between the two sides is picking up. For the first time, Pakistani and Indian mobile-phone companies have been allowed to open up communications for Kashmiris. And the Line of Control through Kashmir is expected to open for citizens to cross. Kashmiris hope the moves will lead to the declaration of an independent state. At the least, talks between Musharraf and Indian **Prime Minister Manmohan Singh** stand a chance of making progress.

–By Naween A. Mangi in Karachi

CHURCH SPEAKER Lewis is known for exhorting the staff to lose old ways of thinking

At Sears, a Great Communicator

New CEO Lewis will need his people skills to overhaul the giant's hidebound culture

AS AYLWIN B. LEWIS addresses a group of Kmart managers at a dinner meeting, the years spent at the Baptist church where his father served as deacon show through. "Our worst stores are dungeons!," bellows the new chief executive of Sears Holdings Corp. "Well, who wants to work in a dungeon? Who wants to shop in a dungeon? Who wants to walk into an environment that is so dull and lifeless that it is sucking the air out of your body?" At the end of his 25-minute unscripted speech, the managers—whom he has been implicitly criticizing—hoot loudly and give him a standing ovation.

It remains to be seen whether Wall Street will demonstrate equal enthusiasm. With his promotion in September to chief exec of the recently merged Kmart Corp. and Sears, Ro buck & Co., Lewis the right-hand m in billionaire Edwa S. "Eddie" Lamper unprecedented many say impossible—bid to get t 330,000 employees of the two ailing ret icons to think as if they are working "fo $55 billion [sales] startup."

In many ways, Lewis is Lampert's i dispensable alter ego. The 43-year-o Lampert (BW—Nov. 22) spends most his time at his Greenwich (Conn.) i vestment partnership, ESL Investmen often patched in via video conferen Lewis, 51, is the leader whose physic presence is felt most at Sears' Chica area headquarters and its 3,500 U stores. Lampert can seem aloof; Lewis an engaging orator. The duo share t sides of what most companies wou consider one job. At Sears, it is Chairm Lampert who sets strategy. It is CE Lewis who must remake the retaile cultures in order to firmly impleme Lampert's vision. "I am in the forest, a he is on the 50th floor," says Lewis, w gave *BusinessWeek* the first in-depth a cess that he has granted since he join Kmart as its head a year ago. "It's ha for him to see in the mud." Adds La pert: "He has demonstrated to me, m than I thought before, what it takes get people aligned around ideas."

THE BARBARIANS

LAMPERT CREATED the nation's thi largest retailer through some fancy fina cial footwork. He gained control Kmart at a bargain price when it was bankruptcy, took it public in 2003, a then used its buoyant stock to snap up struggling Sears. In the wake of the mer er and the layoff of 1,500 headquarte employees, some survivors privately ref to Lampert & Co. as "the barbarians," reference to business classic *Barbarians the Gate*. The speculation is that La pert—who has no history of building o erating businesses—bought Sears a Kmart as real estate plays and will eve tually liquidate the companies.

Lampert says that's not his aim, a that there's bigger upside in turni Sears around. To do so, he is rejecting t ditional competitive practices in retailin by placing profits before sales growth and not worrying about loss of mark share. But with department stores in de cline, and with Sears' tired brand havin defied the rescue efforts of veteran ret CEOs in the past, the stock market co siders a Lampert-led turnaround a lon

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shot: Since climbing to a peak of 163 in July, Sears Holdings' stock price has plunged 27%, to 118.79. "I'm glad people think we can't pull this off," says Lewis. "I absolutely love that fact."

Lewis has gone down improbable paths before. Rowena Lewis, one of two younger siblings, says her brother developed a knack for speaking in Sunday school, where students had to tell Bible stories. After gaining dual degrees in English and business management from the University of Houston, he pursued a Masters in English, intent on becoming a professor (box). But a job as an assistant manager of a Jack in the Box restaurant changed that. He found that leading his restaurant staff "satisfied my need to teach."

THE COACH APPROACH

FOR THE NEXT 26 YEARS, Lewis stuck with restaurants, climbing the management ranks at Jack in the Box, then YUM! Brands Inc., a former PepsiCo Inc. division. A recruiter and a person close to PepsiCo says executives were divided on Lewis' potential to handle the broader strategic role of CEO at YUM! But as operations head for the company's KFC and then Pizza Hut restaurants, he left no doubt about his ability to manage nitty-gritty details. He helped lead turnarounds in both chains, ultimately rising to president of YUM! "He was the best operating guy we had," says YUM! Founding Chairman Andrall Pearson.

One reason for his success was his deep understanding of the business. Former colleagues say he spent at least three days a week visiting restaurants. They also praise his leadership skills. Although Lewis set tough objectives, he developed loyal subordinates by working closely with them to meet targets. This is why, at YUM!, he changed titles such as "district manager" to "district coach" to reinforce management's development role. (Managers at Kmart are now also "coaches.") He was quick at identifying talent so businesses would continue to perform once he moved on—what Lewis calls making "footprints in concrete."

As one of the most visible African American executives in the U.S., Lewis has held high-profile director posts at Halliburton Co. and Walt Disney Co. Robert A. Iger, who succeeded Disney CEO Michael D. Eisner on Oct. 1, says Lewis is a strong communicator who cuts to the heart of issues. In an interview with Lewis during the Disney board's CEO search, the top internal candidate recalls being caught off guard by the board member's directness. "The first thing he asked was, 'Why do you want this job?' "

If Lampert and Lewis are to succeed with Sears Holdings as a retailer, they know they must radically change its two cultures. Both Sears and Kmart have traditionally been inward-looking instead of focused on the customer. Arthur C. Martinez, a former Sears CEO who led a turn-around in the mid 1990s that fizzled fas can relate. He admits that he underestimated how difficult the Sears culture w to change. "I would have been harder o the people and harder on the organiz tion," he says on what he would do di ferently now. Martinez says he shoul have advocated a " 'throw the bums ou sort of thing."

Lewis and his huma resources team have star ed to put the framewor for a new culture in plac They're rejiggering wor flows to allow store em ployees to spend less tin in back rooms and mo time on the floor interac ing with customers. Sin the merger, Lewis has r quired all 3,800 Sea headquarters employees spend a day working in store (many never had). H practices what he preac es, spending Thursda through Saturday visitir stores. He stays at each o for three hours, probin managers to see wheth they know, say, the pro margins for the electroni department and askir what they need to run store better. He and Lan pert want employe throughout the business be more financially literat The highest complimen an employee can get is to be call "commercial"—meaning someone wh has a sense of how to make money.

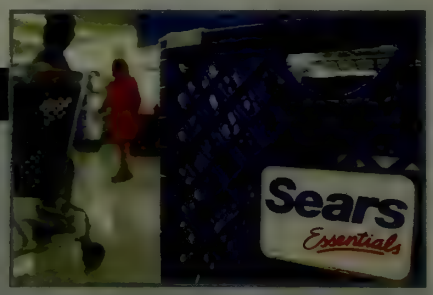
Lewis has identified 500 potential lea ers at the company and is bringing them 40 at a time for a daylong course, "Sowir the Seeds of Our Culture," that he runs. recent session begins with Lampert video, saying that he hopes the course w help them "act in a way that is collabor tive, that is competitive, that is constru tive." Later, Lewis tells them, "Make mistake, we have to change," so either th "drink the Kool-Aid" or they should leav It remains to be seen whether Kmart a Sears will ever get religion. As Lampe shores up Sears' balance sheet, the retaile are gaining breathing room. But breathi more life into the chains themselves will a daunting task. ■

–By Robert Bern in Hoffman Estates, I

PROFILE

Aylwin B. Lewis

A product of Sunday school, football, Jack in the Box—and Ralph Waldo Emerson



MERGER BASH Lampert, Lewis, and then-Sears CEO Alan Lacy cheer Sears' union with Kmart

UPBRINGING Lewis was raised in Houston. His father, Albert, was a handyman and served as deacon in a local Baptist church. Sunday school presentations helped Lewis become a strong speaker. As a varsity football player in high school, he played defensive end and offensive tackle.

DIVERSE DEGREES First, there were dual BAs in English and business management at the University of Houston. Next: a year in a Masters program in English, an MA in human resource management, and an MBA.

HIS CALLING Visions of life as an English professor faded after Lewis took a summer job as an assistant manager in a Jack in the Box restaurant—and loved it. He went on to YUM! Brands and rose to president before leaving for the CEO job at Kmart in 2004. This September, he was named CEO of Sears Holdings.

FAMILY Lewis has two grown step-children through marriage to Novaline Lewis, whom he met working at Jack in The Box.

DOWNTIME The Lewises have visited 75 countries. The trips help balance out Lewis' intense work hours. "I call it marriage protection," he says. The most recent trip was a week in Croatia. Lewis also loves to read; Ralph Waldo Emerson is a favorite.

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Golden Parachutes

Daniel Preston broke his neck skydiving. Guess what business he's in now

NOT LONG AFTER DANIEL Preston took up skydiving in 1998, his parachute opened much too quickly during a jump, exposing him to G-forces greater than he would have endured falling from a three-story building. The shock broke his neck.

But fear of flying? Not for Preston. Five months later he was jumping regularly and searching for the best parachute available. The only one that impressed him was made by Atair Aerodynamics, a Slovenian company. Preston, now 35, met with its founder and in 1999 opened a division of the company in a converted 19th-century warehouse in Brooklyn, N.Y., with a view of the Statue of Liberty.

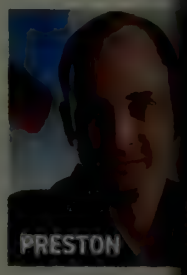
These days Atair Aerospace, an independent 14-person spin-off, is getting attention for its parachutes, made with an innovative material, and the computer systems that make them self-guiding. Preston has been working to solve a vexing problem for the military: Personnel and cargo must be dropped from low-flying planes to land anywhere near their targets. That leaves aircraft vulnerable to surface-to-air missiles. But Atair's Onyx System can be dropped from 35,000 feet and land within 150 feet of its target. And Atair's "flocking" algorithm allows up to 50 units to be dropped at once without colliding. "What really sets Atair apart is this technology," says Edward Doucette, director of air-drop engineering at the U.S. Army Natick Soldier Center in Natick, Mass. Atair has won $1.3 million in government contracts.

BUSINESSWEEK SmallBiz

Preston is a soft-spoken New York City native who started college at age 12, attending several schools but never graduating. He trained to become a master glass-blower and in 1989, at the age of 19, he turned his hobby into a specialty glass company that also designed and built high-speed automation systems. Preston sold it in 1999 for $4.3 million. Some of that money funded Atair's early efforts. He's also raised about $5.5 million in angel funding.

TAKING WING Preston (in blue) tries out an Atair suit

Preston's first task in building a better parachute was to develop a material that would open more smoothly and with less stretching than the nylon used since World War II. He created a composite fabric by using extreme heat and pressure to bond high-strength Spectra fibers between two layers of ultrathin polymer. The material is three times as strong and less than one-third the weight of standard parachute nylon. And it stretches only one-sixth as much. Preston calls it "the Holy Grail of parachute fabric."



PRESTON

The fabric's military applications were obvious. Initially reluctant to go that route, Preston "started to think about it differently after September 11." Two months later, he spun off Atair Aerospace. At first the military rejected Atair's proposals for a self-guiding parachute. "They told me we were so far ahead they didn't think it would work," Preston says. He built the prototype anyway, and demonstrated it for military officials. "I blew them away," he says. In 2002 he won a $1.1 million Small Business Innovation Research grant to develop it.

Atair now has products from navigation aides to guide Special Operations forces to "monster" parachutes, including one used in a self-guiding paraglider that the military may use for surveillance. The company has nine patents and 86 pending. In a recent exhibit at the Smithsonian's Cooper-Hewitt, National Design Museum in New York, Atair's composite fabric hung a few feet from the Wright Brothers' 1902 glider.

Preston intends to keep his staff lean, growing instead through strategic partnerships. Five have been signed so far. "I don't want to grow so fast that we can no longer do what we do best, which is find innovative solutions quickly," he says. That may leave him more time for inventing and, of course, skydiving with one of Atair's parachutes. ■

–By Susan Price in Brooklyn, N.Y.

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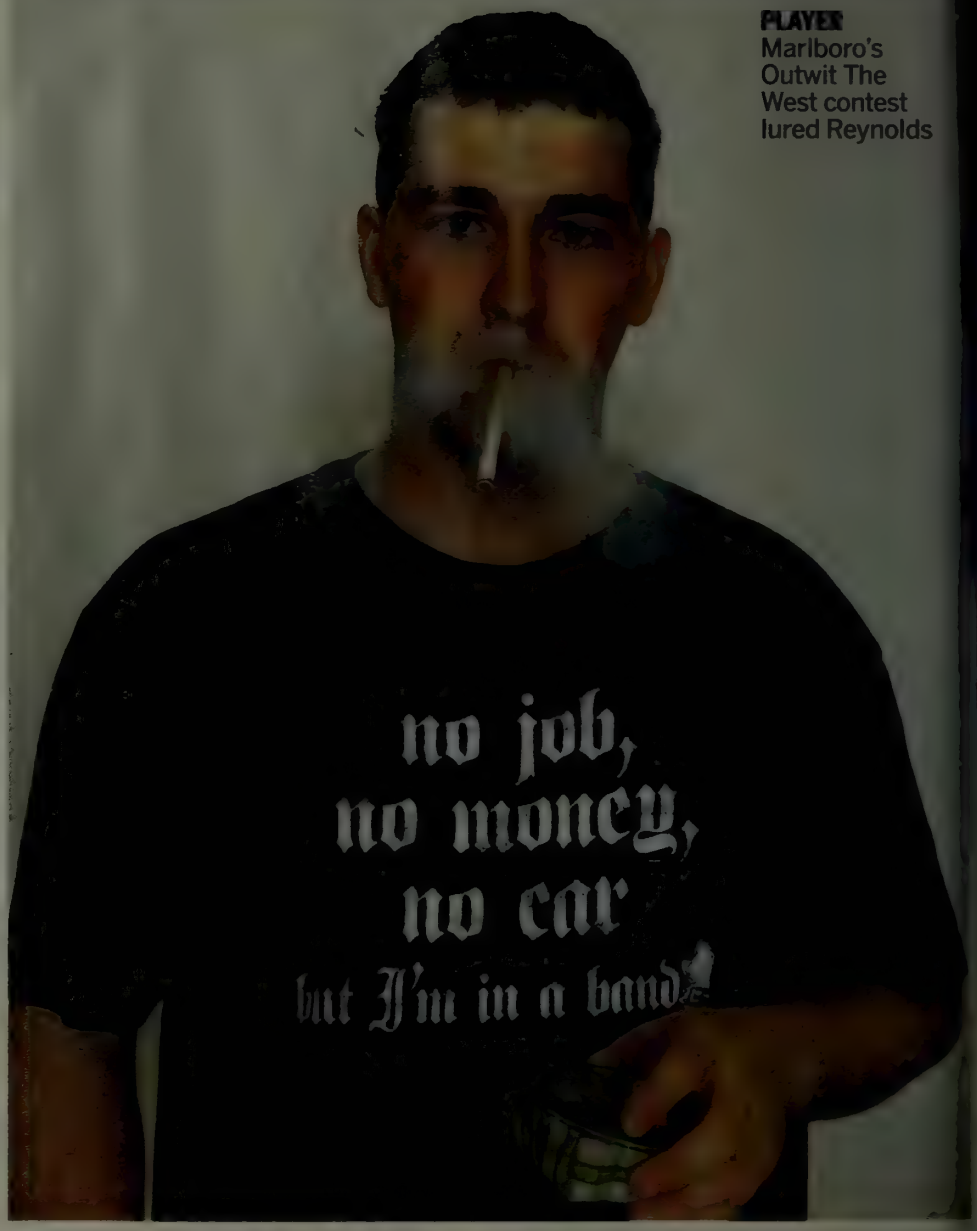
Leader Of the Packs

Marlboro is still smokin' at 50, thanks to buzz marketing



PLAYER Marlboro's Outwit The West contest lured Reynolds

ON NOV. 5, CAREFULLY selected invitation-only crowds of a few hundred people each will gather in 49 cities around the country for a glitzy, star-studded birthday bash. In New York, audiences will listen to rocker Lenny Kravitz. In Chicago, they'll hear pop from John Mellencamp. And in Miami they'll be dancing to Marc Anthony.

What's all the fuss about? Marlboro cigarettes. The smokes as we know them turned 50 this year, and to wrap up a year of promotions and parties, Philip Morris USA Inc. and parent company Altria Group Inc. have pulled out the stops.

There may be a cloud of condemnation hanging over cigarettes, but the companies nonetheless have plenty to celebrate. Long the U.S. market leader, Marlboro has been hitting all-time highs this year. Despite the sharp advertising restrictions agreed to by cigarette marketers in 1998 and a dramatic rise in state excise taxes since 2002, Marlboro is galloping ahead of the competition. The brand, which commands an average $3.28 per pack, now owns more than 40% of the market, up more than 2½ percentage points in as many years. That surge has driven a broader gain for Philip Morris overall, which also makes Virginia Slims, Parliament, and other brands, and added significantly to the company's profits, possibly more than $200 million a year.

Marlboro became one of the world's most valuable brands the old-fashioned way—traditional mass marketing. For decades, Chicago ad shop Leo Burnett burned Marlboro into the consumer psyche with TV, magazine, and billboard images of freedom and cool personified by the rugged, horse-riding, Stetson-wearing cowboy.

> "An online community sprung up around [the contest] and I made a lot of friends"
>
> —*Eric Reynolds, Marlboro smoker*

But if Marlboro got to the top using an old tool kit that's now restricted, it's holding on to that spot with a blend of tactics for the new age: so-called "buzz" marketing at live events and bars that spur Internet chatter and sign-ups for promotional offers; a Web site where smokers sign up for a chance at discounts and bling; plus a healthy dollop of price promotions and direct mail. Philip Morris does not disclose how much it spends promoting the brand, but the company says it has been spending less on marketing in general each year. That's in contrast to the rest of the industry. In 2003, more than $15 billion was

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Outthinking Outdoing

spent on marketing cigarettes in the U.S., according to the most recent data from the Federal Trade Commission—a 21% jump over 2002.

One hot spot in Marlboro's marketing is a growing database of 26 million smokers to whom it sends everything from birthday coupons to the chance to attend events like November's birthday concerts. Indeed, Marlboro isn't just a brand, it's an exclusive club for its devotees, who wouldn't miss an opportunity for a discount and often feel victimized by social pressure and no-smoking laws. The average consumer, for instance, might even have missed Marlboro's birthday altogether: The only mass-market evidence of it was two two-week runs of cigarette packaging featuring a special anniversary cover and some signs in stores.

FREE DRINKS

BUT TO THOSE in the loop, it has been much more of a celebration. A special booklet of 50 Marlboro prizes—everything from a Zippo lighter to a live quarterhorse—was mailed to the Marlboro faithful. Some of the prizes can be bought with Marlboro Miles earned on each pack bought. Others are awarded by sweepstakes. Marlboro arranges special trips to a ranch it owns in Montana, where vacationers are showered with gifts, eat five-course meals, drink for free, and enjoy massages, snowmobiling, horseback riding and the like, all on the company tab.

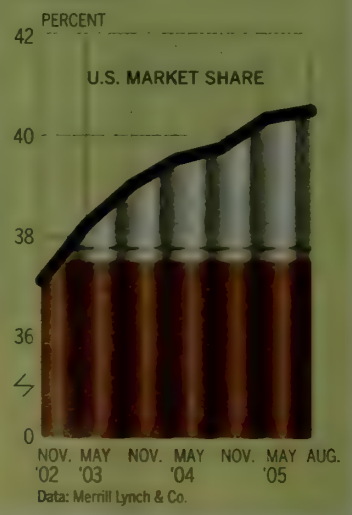
Such extravagance builds loyalty that's hard for rivals to dent. "I'd never smoke another brand of cigarette," says Michael Thomsen, a 30-year-old pack-a-day smoker from Wake Forest, N.C., who runs his own home-repair business. Thomsen got a ranch trip for his birthday last year and has also won breakfasts out, and a day at the races in Richmond, Va. He is waiting to hear if he won a ticket for one of the concerts.

Built by company field reps who stake out bars, as well as through Internet sign-ups and calls to an 800 number, the Marlboro database populates events with smokers who often feel under siege in an increasingly smoke-free world. Marlboro's Outwit The West contest taps that mindset perfectly. Part scavenger hunt, part trivia game, it is all about the American West, Marlboro's marketing home turf. Teams of four compile answers, and the winners get $1 million. "A whole online community sprung up around it, and I made a lot of friends from it," says Eric Reynolds, 26, a systems administrator who lives in Longview, Tex. He didn't win the prize.

Antismoking advocates may find it ironic that Philip Morris has become a more deft and efficient marketer as a result of the legal settlement that sought to hobble the cigarette makers. Back in 1998 the Master Settlement Agreement (MSA) with the state attorneys general ended tobacco advertising in most of its traditional forms. But by forcing Marlboro to go viral, be aggressive in retail stores, and be more creative in its media plan, it put the company on a successful path now being followed by every marketer from General Motors and Audi to AXE deodorant. Today, all kinds of companies are pursuing similar viral marketing campaigns that draw consumers into brand communities. Marketing expert Dave Balter, founder of BzzAgent, a Boston-based public-relations company, and author of *Grapevine: The New Art of Word-of-Mouth Marketing*, says tobacco ad restrictions have forced a sell job that is more effective in the media-saturated world.

ALL LIT UP

Long the No. 1 cigarette, Marlboro has overcome tax hikes and advertising limits to increase its dominance.



Marlboro can well afford to scoop smokers up with high-priced rewards. Even after the cost of defending the myriad lawsuits against it, the tax bite the government takes, and the billions tobacco companies are paying to states for medical costs under the MSA, cigarette makers can charge a high enough price to earn a healthy profit. Merrill Lynch & Co. analyst Christine Farkas expects operating margins for the company overall to reach 28% next year, from 26% in 2004, as net income grows to an estimated $11.4 billion on $66.3 billion in sales in the U.S. and abroad. That's twice the current operating margin of well-run companies like General Electric and Exxon Mobil and also well beyond Procter & Gamble's 19% margin this year.

Marlboro relies on in-store promotions, price cuts, and bling

Contests and rewards may keep smokers loyal, but to add new acolytes, marketing experts say some low-tech means of persuasion are also important—most notably in-store promotions, price cuts, and other deals. According to the Federal Trade Commission, of the $15 billion in tobacco marketing in 2003, some 80% was spent on discounts and incentives to retailers. "The ballgame's in the store," says Marvin E. Goldberg, a marketing professor at Penn State.

Marlboro is winning that one, too. Coney Elliott, who runs 22 Kent Kwik Convenience Stores in and around Midland, Tex., pays $5.50 less for a carton of Marlboros than a carton of Camels. He has agreed to a deal that gives Philip Morris 66% of his cigarette shelf space and, he estimates, about 80% of the tobacco display at his local Wal-Mart is also Philip Morris. Marlboro is by far the dominant brand in his market, but he says Philip Morris also offers him a better deal than competitors, including R.J. Reynolds.

Health experts are gratified at the lower levels of smoking in the U.S. these days, but they and others still have plenty of criticism for Marlboro's tactics. In its pending RICO case against the company and others, the Justice Dept. has argued that Philip Morris knowingly marketed to underage people in its database, a charge the company denies.

Rivals are unhappy too, and complain that the ad restrictions leave them with little chance of closing Marlboro's lead. R.J. Reynolds Tobacco Co.'s Executive Vice-President of External Relations Tommy J. Payne says his company uses some of the same direct marketing tactics as Philip Morris, but the mass market restrictions still hurt. "If you have 50% of the domestic market and the ability of your competition to react to that [is limited], you don't have to have a Harvard MBA school degree to know who benefits," he says. "It's the bigger brand." And Marlboro is growing despite the fact that Philip Morris has self-imposed a tougher restriction on ads than the law requires, volunteering to keep ads out of magazines altogether. If the tactics are unpopular, it's in no small part because they're working so well. ■

–By Nanette Byrnes in New York

Storm Warnings For Kevin Martin

The new FCC chairman is about to confront issues that divide business

IN A HUSHED HEARING ROOM at the FCC headquarters last May, Cheryl Waller choked back tears as she recounted the death of her three-month-old daughter. At 6:35 p.m. on Mar. 24, the baby stopped breathing. The frantic mother dialed 911 several times but got only a busy recording. Finally, a neighbor reached a 911 operator—but by the time paramedics arrived, it was too late. The infant was pronounced dead at 6:51 p.m.

Waller blamed her Internet phone company for failing to hook up to a 911 call center. She urged the Federal Communications Commission to pass Chairman Kevin J. Martin's proposal to require Internet carriers to tighten up their emergency services within 120 days—"seven days longer than my daughter lived," said Waller, dissolving into tears. "She died at 113 days old because I could not reach 911." All four members of the FCC promptly voted to back the chairman's plan. "You have made a difference," Martin told Waller.

It was just the difference Martin was looking for when he invited the grieving mother to speak. His proposal to impose traditional phone regulations on nascent voice-over-Internet phone technology faced industry opposition and potential dissents from FCC commissioners. But Waller's account helped him carry the day with a bit of political theater, rare for dry regulatory proceedings.

TELECOM'S HARRY POTTER

TACTICS LIKE THESE have helped the 38-year-old FCC chief win a string of victories since he took over the agency in March. Facing a 2-to-2 party-line split among commissioners, Martin chose to plow ahead without waiting for the Oval Office to fill vacancies that would give him a GOP majority on the five-member panel. That has required the soft-spoken North Carolinian—dubbed Harry Potter, for his boyish looks, by telecom insiders—to horse-trade with his Democratic colleagues.

UNLIKE MIKE
Martin is more conciliatory than his predecessor

Martin's results—including a unanimous vote for a proposal to free DSL broadband services from traditional telephone rules—provide a sharp contrast with the record of his predecessor, Michael K. Powell. By as soon as Oct. 28, Martin wants to notch another win, approving the historic mergers of two of the Baby Bells with their onetime long-distance rivals: SBC Communications with AT&T and Verizon Communications with MCI.

But those deals could also mark the end of Martin's oh-so-smooth sail. Just on the horizon are hot issues—from charges of indecent broadcasts to media consolidation to next year's rewrite of the telecom laws—that could be contentious. "Will he avoid a policy shipwreck on his watch?" says Jeff Chester, executive director of the Center for Digital Democracy, a consumer advocate. "I'm not so sure."

So far, though, Martin has managed to steer clear of the controversies—such as sweeping deregulation of the telecom and media industries—that plagued Powell and embarrassed the Bush Administration. In contrast, "Kevin can achieve the clear objective of free markets, but in a way that builds consensus," says White House Counselor Dan Bartlett. Says Martin: "I am willing to stand up for principles. But nobody

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has a monopoly on the right answer.

The fourth of five children of an insurance salesman and a homemaker, Martin hardly seemed destined to become a political broker. Growing up in rural Waxhaw, N.C., near Charlotte, he suffered such severe asthma that doctors ordered his parents to install air conditioning and keep him inside, where he could only watch other kids play from afar. But the self-described bubble boy developed drive and an ability to size up other people. "When my health did improve in the fifth grade," Martin says, "I had a strong desire to interact more with my peers, because I wasn't able to before."

WAR ROOM

HE MADE UP FOR LOST time, playing high school football and serving as student body president at the University of North Carolina at Chapel Hill. After graduating from Harvard Law School, where he met his wife, Catherine, now a White House Deputy Assistant to the President, he joined the FCC as an aide in 1993. Then, a stint as the Bush campaign's general counsel—including a key role in the Florida recount in 2000—catapulted him to an appointment as an FCC commissioner a year later.

Martin's innate political instincts have kicked in time and again. The morning Katrina hit, he set up a war room to approve emergency requests for rule

Martin's Minefields

Three thorny issues for the FCC chairman

INDECENCY The FCC plans to rule soon on a large package of citizen complaints about specific TV and radio shows
RISK Broadcasters may sue to overturn the government's authority to rule on indecency

MEDIA With courts rebuffing the FCC's attempt to allow greater consolidation among TV, radio, and newspapers, the agency must try again to carry out Bush's deregulatory agenda
RISK A populist backlash

RURAL PHONE SERVICE With the Net and cell phones killing off carriers, Congress must find new ways to support rural service, which has been subsidized by taxes on long distance
RISK The FCC could wind up in the middle of a fight between politically potent rural phone carriers and new telephony providers

Data: *BusinessWeek*

nges to keep phone and broadcast ices operating in the storm zone. en Clear Channel Communications employees seeking fuel for their New ans generators were held up at gun- t by looters, the FCC persuaded the eral Emergency Management Agency rovide armed guards and fuel from Baton Rouge.

e FCC irman ved ckly in rina's ke

After a tour of the Gulf Coast, Martin announced the allocation of $211 million in universal service funds—normally used to connect low-income and rural households to phone service—to provide aid, including free wireless service, for storm victims.

he FCC's two Democrats went along the unorthodox use of the funds in e part because of Martin's earlier ndwork. In August the FCC chief given the Democrats a key role in vote to deregulate DSL. The Democ- feared that the move would let, say, zon provide more efficient broad- d service to its own Internet phone ice than to an independent provider as Vonage Holdings Corp. Martin e the Democrats a carrot—allowing n to attach a statement endorsing al access for all providers—but made lear that their influence would ndle if they stalled on passage until FCC had a GOP majority. Martin got to-0 vote.

ome issues aren't likely to play out so ly. The FCC's crackdown on broad- s deemed indecent, a key issue for h Administration conservatives, will Martin's political skills. He has come n squarely on the anti-smut side, de- ing war on TV networks by suggesting the FCC could allow local stations to k more network programs they find nsive. One outraged network execu- suggests that Martin is cozying up to l broadcasters in case he wants to run office.

Martin declined to respond—and won't where his ambitions lie. But as FCC is- s grow thornier and the one-time bub- boy repeatedly has his political mettle ed in the real world, he can expect ty more of those potshots. ■

–By Catherine Yang in Washington

BusinessWeek online For an extended view with FCC Chairman Kevin Martin, o www.businessweek.com/extras

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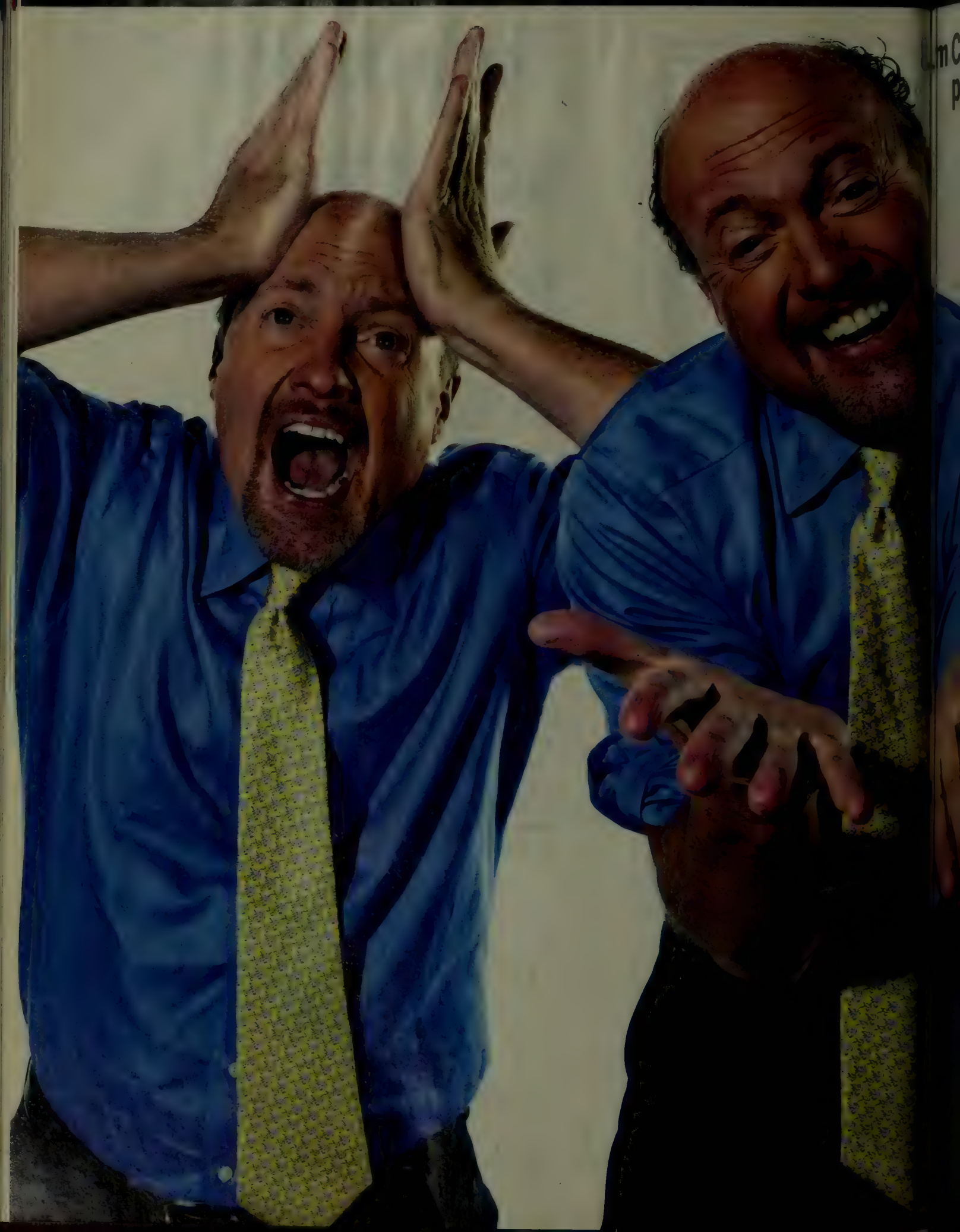

Jim Cramer wants to make you a lot of money. He's got plenty himself, so why does he bother? BY ROBEN FARZAD

THE MAD MAN OF WALL STREET

Photographs by Brad Trent

BEFORE THE MARKET OPENS on a gloomy mid-October Friday, the hyperkinetic, red-faced Jim Cramer is pacing the floor of TheStreet.com Inc.'s headquarters at 14 Wall Street. He's obsesssing over news reports: The Food and Drug Administration has seized thousands of allegedly faulty drug-infusion pumps made by Baxter International Inc. The company says it's trying to fix the problems as fast as possible. But Cramer is shaking down his "brain trust" of five twentysomethings for leads on which competitors stand to steal a march on Baxter.

"Oh no. Come on!" bellows Cramer, 50, pulling up stock data on the panoply of Bloomberg screens that wallpaper his workstation. "We've gotta get on this!" he barks, launching out of his chair, sleeves rolled up, demanding research reports and calls to Wall Street trading desks and relevant executives. It's barely 9 a.m, but you already know that James J. Cramer will be talking, instant-messaging, writing, and fixating on this pump thing all day long.

It's pouring outside for the eighth straight day. Across the street at the New York Stock Exchange, traders are digesting a bad inflation number that will likely spook the market lower for the third week in a row. It's one of those days that undoubtedly has the average Street drudge plotting his escape with the desperation of a Shawshank lifer.

Cramer has been there and done that. He paid his dues in the '80s as a Goldman, Sachs & Co. broker, followed by 14 years at Cramer Berkowitz, his $450 million hedge fund, where he earned an average return of 24% a year after fees. There, he had enough mega-paydays to kiss the Street hustle goodbye forever. With a net worth he says is between $50 million and $100 million, you might think Cramer would be out bronzing in St. Barts with daiquiri in hand.

Instead, he rises at 3.45 a.m. weekdays. After scanning headlines online, checking messages, and shooting e-mails to his TV producer, he works out in his Summit (N.J.) home gym until 5.30 a.m., when he calls traders and brokers and writes his first online story. Later, Cramer carpools his younger daughter, Emma, to school, before setting off on the 75-minute trek to Wall Street. By the time his workday is over, usually around 7 p.m., his driver will have logged 120 miles, Cramer will have banged out six W columns, done a radio show, and scoured his larynx taping *M Money*, his surreal nightly call-in show on CNBC that is perha best described as Louis Rukeyser meets televangelism mee *Pee-wee's Playhouse*. At some point, he'll work on his month column for *New York* magazine. "I'm hard-core about the ma ket," he says, his bobble-head emerging from a wall of flicke ing screens.

At one level, none of this makes much sense. With the ma ket trading sideways and in danger of posting its fourth losi year since 2000—and real estate still the cocktail party topic choice—stockpicking is not exactly a growth industry. (Cra trades stocks for a charitable trust; he no longer owns a stocks personally, other than his 15.4% stake in TheStreet.co which he co-founded, worth about $15 million.)

Why, then, is Cramer so in-your-face? In the aftermath New York Attorney General Eliot Spitzer's attacks on W Street research, analysts hide behind weaselly ratings such "In-Line" and "Equal Weight," and scores of stocks are longer covered. "The analysts," Cramer pronounces, taking break from another drug-pump tantrum, "they are colorl and odorless and sanitized and fear Spitzer to the point death." Even CNBC, he complains, is "terribly gun-shy abo being anything but 'corporate crime watch' when people s need to make money."

Cramer senses a huge information vacuum. "You can't just neutral on everything," he says. "Go see a shrink!" What he se is a woefully underserved mar for unabashed, aggressive sto picking—his kind—that is lac with bombastic sound bites li "Back up the truck!" and "G the paddles!" and lends its to the showmanship that h made *Mad Money* a cult hit wi 384,000 nightly viewers. Warren Buffett, Cramer is trading mercenary to t core. His rapid-fire and-out moves are ra ing chat room buzz levels not seen since d traders reigned supreme du ing the bubble. All of which h turned CNBC's once-moribu 6 p.m. slot into one of its top-r ed hours. "What's smart abo *Mad Money* is it does away wi the usual boring guests and le Cramer vent in a way that is ha not to watch," says *Washingt Post* media writer Howard Kur who profiled Cramer in his bo *The Fortune Tellers*. "It occupi some sort of netherworld b tween sheer entertainment a useful financial advice."

On-screen antics such as an mal noises and airborne chai don't faze the Cramer faithf "You could put him in a clow suit for all I care," says Phil Mason, a law student and cert fied public accountant in Hou

TOCKPICKER'S EMPIRE

Cramer has grown into a one-man multimedia concern, allowing fans near-constant access

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nmentator, and
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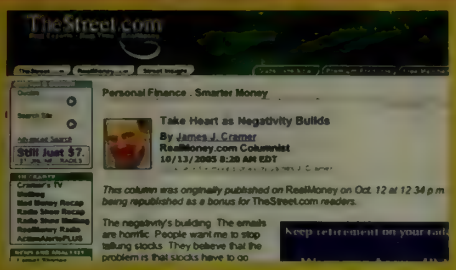
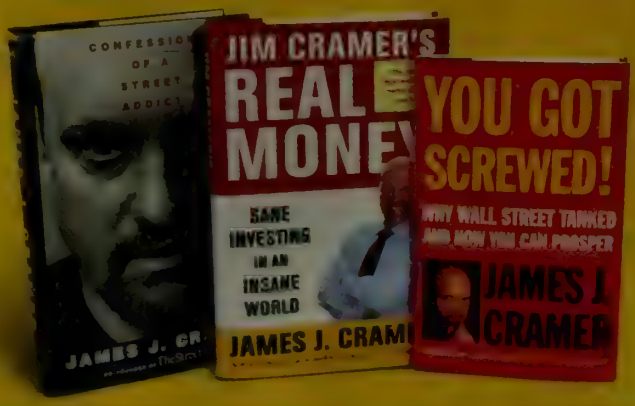
ion to 50 million.



BOOKS Published his third book, *Jim Cramer's Real Money*, in April. Follows earlier books, *Confessions of a Street Addict* and *You Got Screwed!* Total sales to date: 300,000.



ts CNBC's *Mad* ney. Viewers per nt: 384,000.

MAGAZINES
Writes a monthly column, called *The Bottom Line*, for *New York* magazine. Circulation: 437,200.

RADIO
Hosts *Jim Cramer's Real Money*, nationally syndicated on WOR Radio Network. Weekly audience: 355,000.

who watches *Mad Money* avidly. "He's an excellent stock ener who gives me ideas when I am not doing that well on own." Mason credits Cramer for persuading him to get into orola Inc. at 18 in June. (The stock is now at 21.) Cramer made Brian Johnson, a *Mad Money* blogger in Tacoma, h., wealthier—albeit unintentionally. Johnson's blog, ch tracked Cramer's on-air stock picks, drew as many as 00 monthly hits and enough banner ads to make him con- r quitting his day job—until, he says, CNBC slapped him a cease-and-desist letter. "It was incredible," he says. mer's fans wrote me constantly."

or Cramer, all of this is a long way from his old hedge fund . "When I took your money," he says, "you owned me. ve the 13th Amendment. I wanted to get rich—that was the nant." Burned out, Cramer cashed out of his hedge fund at end of 2000—the dot-bomb year in which his fund nced the Standard & Poor's 500-stock index by 38 per- age points.

ut his here and now, he insists, is journalism, which he ars was his first love all g. You have to take at least e of that claim at face val- After all, he worked his way to editor-in-chief of *The vard Crimson*, where he was ble rouser with an Afro who allies against apartheid and ard Nixon on the side. An at- in the *Crimson* on alleged elitism in the history department he says, to the administration's withholding his diploma at luation. "My parents were crying," he says. "It was horri- (He did finally manage to wrest the diploma from Harvard summer.)

POST-SPITZER, Cramer sees a vacuum of market advice, which he aims to fill

pon graduating, Cramer slummed his way through several y-level reporting jobs in search of his big writing break. mer pulls out his wallet and carefully peels out a ripped, at-stained pay stub for $172, dated Mar. 1, 1978, from the *hassee Democrat*, where he covered the Ted Bundy murders. n-executive editor, Richard Oppel, says "Jimmie was like a ng ram. He was great at getting the story." While that tenac- nade Cramer a successful reporter in both Florida and Cali- ia, his finances were in a shambles after his house was bur- glarized and checking account emptied. He ended up homeless, and for nine months slept with a .22-caliber pistol and a camping hatchet in his beat-up Ford Fairmont—a lurid chapter of his life he describes in his memoir, *Confessions of a Street Addict*.

Cramer recalls getting pulled over by a bunch of Colusa County (Calif.) police officers. "Like I would have a license and registration when I was living in my car," he quips. The officers held him splayed atop the hood of his Fairmont for two hours, pulling his ears. (Cramer thought they were trying to force an armed-robbery admission out of him; in fact, they were looking for a robber with an earring.) "My dad cut off my Amoco card and told me to get a real job," he says. "I hit rock bottom."

ALTHOUGH HIS OLD *Harvard Crimson* buddies later helped him land a job at *The American Lawyer* magazine in 1979, when he slept on the floor of his sister's Greenwich Village apartment, Cramer finally yielded to his father's insistence that he apply to law school. "I figured maybe I could become a prosecutor," he says, shrugging his shoulders.

In 1981, Cramer returned to Harvard. There he had access to the just-launched Financial News Network, the forerunner to CNBC. With its nonstop ticker and real-time analysis, FNN rekindled Cramer's long-dormant interest in stocks. As a child in Philadelphia, he used to memorize ticker symbols from business pages that he spread all over the living room floor and ran a fantasy portfolio. While cutting his law classes, Cramer would either be in his dorm watching FNN or at the business school library waiting to pounce on new stock research. "It was unbelievable," he says. "This was it for me. I knew it."

With money he earned working as a researcher for law professor Alan M. Dershowitz, and as a miserable summer intern at the Manhattan law firm Fried, Frank, Harris, Shriver & Jacobson LLP, Cramer started dabbling in obscure stocks such as Standard Press Steel, American Agronomics, and Bobbie Brooks. "Nothing but oil was working," says Cramer. Still, he felt the market was on the cusp of a big rally, and

he maxed out his academic loans to raise money to invest.

As his brokerage account swelled, so did Cramer's obsession with the market. He started leaving stock tips on his answering machine every Sunday night. He recalls, "I was like, 'Hi, this is Jim Cramer. I'm not here right now. Take a look at PEOPLEx-press, which has a good business model . . .'" Dershowitz urged him to register as an investment adviser. Cramer agreed, but says back then he never considered himself more than an amateur with a knack for making money.

ENTER MARTIN PERETZ, editor of *The New Republic* and Harvard professor, who approached Cramer out of the blue with a $500,000 check. Peretz, who would later co-found TheStreet.com with Cramer and invest in his hedge fund, had been profiting from tips on the answering machine for months (after initially calling to ask him to write a book review), and wanted Cramer to run his money. "He seemed to know very deeply so many stocks," says Peretz, who would prove loyal. "At one point, I was down $80,000 and he didn't give up on me," says Cramer.

Cramer made Peretz $150,000 in two years. He parlayed his record into a three-year stint as a broker to the ultra-rich at Goldman. Then he spent nearly 14 years at his hedge fund, opened in 1987, where he routinely took home $10 million a year and more.

Back to 2005. It's 10:50 a.m. Cramer peeks at his watch, launches himself out of his chair, and is halfway out the door. "My producer is going to kill me," he says. "Pumps! We've got to find out about these pumps. Gimme ideas!" he hollers to his brain trust one last time, struggling into his jacket as he heads for the exit.

With the area in front of the NYSE closed to traffic, Cramer walks 40 yards to meet his driver for the commute to CNBC's studios in Englewood Cliffs, N.J. It's still raining, but Cramer couldn't care less: He lives for this not-so-random walk down Wall Street. This is Cramer as Stock Star, as a *Mad Money* viewer once called him. The instant he hits the street, he's getting winks and "booyahs!"—the show's trademark shout-out—and dumbfounded stares from Wall Streeters and tourists alike. "Look. Look. It's him, the Cramer guy," says a sneaker-clad woman to her husband and two sons. "It's the crazy money man from CNBC," a man on a coffee break whispers into his cell phone, before aiming the phone at Cramer for a snapshot. Just as Cramer settles into the back seat of his BMW 760 and hooks his laptop up to the cigarette lighter, a woman taps on the window. "Could I get a picture with you?" she asks breathlessly. "I love your show." He obliges.

Cruising north along the East River, Cramer wastes no time. "Just let me check some e-mails," he says, pulling out stacks of research and clearing away the newspapers, magazines, and wires littering his mobile control room. The instant his wireless card picks up a signal, messages from his brain tru about several investment themes pop up on his screen: Baxt Occidental Petroleum, Africa. Yes, Africa. Fed up with the U budget deficit and what he views as Federal Reserve Chairm Alan Greenspan's intransigence about raising rates, Cramer on an Africa kick today, looking for gold plays there. After yea of making rich people even richer at Goldman and Cram Berkowitz, Cramer says he wants to help the little guy. "I'm tr ing to show people at all times what I would be doing at the c job," he says, already halfway through one last online colum for the day. "I want to keep you in the game—keep you fro getting discouraged."

CRAMER'S critics aren't hard to find, but it's tough to argu with his recent stock picks

To the consternation of his CNBC publicist in the front seat, blows a kiss to Roger Ailes, the former head of CNBC who left run Fox News and is on the verge of launching a Fox busine channel. Cramer briefly worked for Ailes after Fox picked up Street.com show in 1999, when Cramer was in the CNBC do house. (Cramer later settled after Fox su him for playing hooky from the show.) "I attention to product detail was awe-insp ing," says Cramer. "It always came down 'How often am I helping people make mo ey?'" That's the standard by which Cram says he wants to be measured.

Cramer's forays into TV and print stoc picking, however, have come at a cost to l reputation. In 1995 he drew the attention the Securities & Exchange Commission failing to disclose that his fund owned thi stocks he recommended in a *SmartMon* column. The magazine later took respon bility for leaving off the disclosure; the S wrote to Cramer but never pursued the m ter. Still, a former boss at the *Los Ange Herald-Examiner*, Frank Lalli, who w then editing the competing *Money* mag zine, said that he felt he should have done better job instilling a sense of ethics in l young reporter. "I regret that I failed," wrote. The controversy, Cramer says, ma him deeply despondent and put him medication. "Suddenly," he says, "it's li I'm Ivan Boesky." In December, 199 CNBC briefly suspended him from *Squawk Box* program while it investigat the sell-off in shares of dot-com WavePho which he had blasted on the air. (Neither nor his fund ever had a position in the stoc true to his prediction, it is now worthless

So does Jim Cramer actually make peo money?

Not if you listen to his many critics. Al Abelson, the longtime voice of *Barron* ripped Cramer's boosterism in an Ap 2004, column that argued that Crame

MARKET MAVEN

Since *Mad Money* began in March, Cramer's Picks of the Week have beaten the market

	AVERAGE GAIN* 1 DAY	1 MO.	3 MO.
Cramer's Picks	2.2%	1.9%	7.1%
DJ Industrials	–0.1%	0.4%	0.9%
S&P 500	–0.1%	0.9%	2.5%

BIGGEST WINNERS

	FROM DATE OF PICK TO 10/18/05
Google GOOG	35.7%
GameStop GME	27.5
Apple Computer AAPL	24.5
St. Jude Medical STJ	13.2
McAfee MFE	12.7

BIGGEST LOSERS

	FROM DATE OF PICK TO 10/18/05
Dick's Sporting Goods DKS	–25.1%
Constellation Brands STZ	–14.5
Pfizer PFE	–12.6
Gold Kist GKIS	–10.0
ExxonMobil XOM	–6.4**

*Based on available data **Based on date of sell recommendation
Data: Bloomberg Financial Markets; BusinessWeek

What do you see in the tangram above? We see a wide-open range of opportunities across North America. We see a fast-moving company in search of a trusty sidekick at home in Canada, the U.S. and Mexico. And we see a corporate and investment bank that's ready to ride—anywhere. **We see the future of business everywhere we look.**

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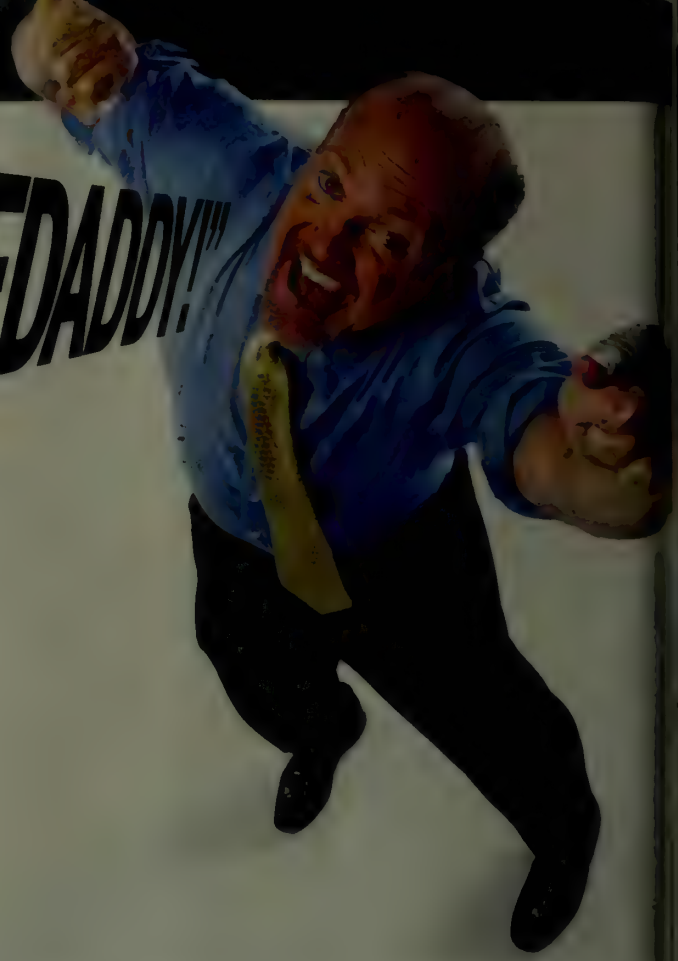

group of then "super six" stocks resembled his 10 dot-com bubble picks of 2000, which ended up tanking by an average of 90%. "In retrospect," concluded Abelson, "a more fitting description of Mr. Cramer's top 10 picks in February, 2000, given their subsequent melancholy fate and the appreciable number that are no longer with us, rather than 'The Winners of the New World' would have been, 'The Winners of the Next World.'"

He's also the target of a regular fusillade of online zingers. "Cramer says Buy, I SHORT BIG TIME," writes a user in a Yahoo! message board for the stock Yum! Brands Inc., which Cramer highlighted on *Mad Money* as a smart play on the boom in China. "When a stock starts receiving the carnival barker treatment on CNBC, I know it's close to the end." Adds another message board regular: "I can't believe anyone actually watches that idiot. I don't know if he's good or bad at picking stocks; I just know he acts like a total FOOL!"

BUT CRAMER'S FANS have his back. Damon Plonczynski, 27, a New York City cop, says he started watching CNBC five months ago, when he resolved to learn how to invest. "The first thing I turned on was Jim Cramer," he says, "and it just drew me into stocks. He's a motivator for you to do your own homework." Plonczynski regrets that he didn't act on Cramer's homeland security and natural gas stock recommendations. "I'm kicking myself," he says.

At the other end of the expertise spectrum is Douglas A. Kass, president of the hedge fund Sea Breeze Partners Management and an occasional *Mad Money* guest. "We disagree on more market subjects than we agree on," says Kass, "but we generally learn from one another." Kass says Cramer persuaded him to cover his firm's short position in Time Warner Inc. stock in spring, 2003, when it was trading at 12. The stock has since gained 50%.

Testimonials aside, Cramer's roster of Picks of the Week from *Mad Money* since the show started in March have jumped an average of 7.1% after three months, according to *BusinessWeek* calculations. That's nearly triple the S&P's 2.5% gain and seven times the meager 0.9% advance of the Dow Jones industrial average. By the end of the first day's trading after Cramer unveils his picks, usually on Mondays, they're up an average of 2.2%, vs. drops of 0.1% each on the S&P and Dow. From the day they were picked to Oct. 18, notable winners include Google, whose shares have soared 35.7% since he recommended them in late April, and Apple Computer Inc., up 24.5% since Apr. 11.

Cramer's undisputed dog is Dick's Sporting Goods Inc. It h fallen 25.1% in the two months since he picked it. "I think I' going to be eating crow about this one for at least the rest of th year, if not the decade," he said in a special "Day of Atonement" *Mad Money* that aired on Yom Kippur. "When you're playi with retail, be skeptical—more skeptical than I was," he sa Cramer readily admits his screwups, both in print and screen—where he will wear a Post-it note with the offendi stock's ticker symbol on his forehead, just as he used to dema of his hedge fund colleagues. "Look, you have to do your hom work," he says, a self-inoculating refrain that he repeats at le 10 times during the course of the day.

"It has nothing to do with being right or wrong," says El Spitzer, Cramer's friend since their days at Harvard Law Scho of the chilling effect his investigations and reforms have had stockpicking. "It was about believing what you said. This i guy who genuinely loves the market and is as devoted to ma ing it work properly as anyone I know."

But just how valuable is a Jim Cramer pick that's revealed af ter the markets close and jumps sharply before average in vestors can buy the next morning? Consider Conexant System Inc., a semiconductor fallen angel that once traded above 30 On Sept. 19, Cramer made it his pick of the week after it closed at 1.63. The next day, it opened at 1.94 and went as high as 2.

HOW TO BUY STOCKS ACCORDING TO CRAMER

In 25 years playing the stock market, Cramer has developed 25 investment rules to live by. Here's a sampling:

- Own the best of breed; don't own too many stocks.
- Don't buy all at once; arrogance is a sin.
- Cash and sitting on the sidelines are fine alternatives.
- Never subsidize losers with winners.
- Just because someone says it on TV doesn't make it so.
- When high-level people quit a company, something is wrong.
- Look for broken stocks, not broken companies.
- Bulls and bears make money; pigs get slaughtered.

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23% spike, with 82 million shares traded—nine times the daily average. "Look, it's difficult," he says, blushing. "I was at *Kudlow & Cramer* for three years and could have stood on my head to recommend a stock, and it would do nothing." He takes a moment to think it over. "My bottom line is, this is a complete work in progress. If I had to do it over on Conexant, I'd say you're an idiot if you buy it at 2."

The "Cramer effect" is making the pros sit up and listen. "He moves the market," says Gregg Goldstein, a Manhattan hedge fund analyst who started paying closer attention to *Mad Money* after an influential researcher in Brazil devoted an entire report to Cramer's TV analysis of Latin American companies. "He's really infiltrating all these areas—my friends, my coworkers, my clients," he says. "Everyone knows who he is and what he's saying."

THE CRAMERMOBILE pulls into CNBC's suburban New Jersey campus at 11:35 a.m. Cramer strides into the building. One imagines Mick Jagger gearing up to play Madison Square Garden. Cramer makes a beeline for his producer, Susan Krakower, another hyperactive character who towers over and gleefully bullies Cramer. She persuaded him to consider the *Mad Money* format and lobbied studio head Jeffrey A. Zucker for the show when Cramer's contract for CNBC's *Kudlow & Cramer* show ran out in late 2004. (Lifelong Democrat Cramer felt like a fish out of water while co-host Lawrence Kudlow extolled all things Republican, when all Cramer wanted to talk about was stocks.) "Susan knows TV business news," he says, before ducking into her office for the requisite high-fives. "She thinks like Ailes."

Krakower eggs on Cramer's on-screen craziness. "Our job is to seduce," she says. "We have that first minute-thirty to capture you." Today, she has the TiVo ready to roll. "The chopping of the heads," she says, "that was so riveting. You've got to go with it." For the final show of the week, she wants to replay Cramer decapitating and castrating little plush bulls—his way of saying that the bears are in control of the market. This summer, she had him film an ad wearing a straightjacket in a padded cell, with two orderlies lifting the drugged stockpick by his elbows. She boasts that NBC is now advertising *Ma Money* during its *Today Show* and across its stable of broadca and cable programs. "That's how much this network believes the show," she says, with infomercial zeal and all sorts of fing wagging and arm touching. She ticks off a list of her boardroo backers: "Immelt, Wright, Zucker" (that is, Jeffrey R. Imme CEO of CNBC parent General Electric Co., NBC Universal CE Robert C. Wright). "That's unheard of," she boasts.

Of course, *Mad Money*, which airs at 6 p.m., 9 p.m., and mi night on both coasts, was less of a gamble than it might seem f CNBC. In the 6 p.m. slot, Cramer averages 184,000 viewers, a 86% gain over *Bullseye*, the show it replaced in March. Cramer total audience grew to 384,000 in October, from 338,000 in Ma While these figures are dwarfed by those of Fox's Bill O'Reill they do finally afford CNBC some lift for its nightly lineup.

It's not yet noon, and Cramer is dousing his gaggle of r searchers and editors in a torrent of stream-of-consciousnes "Baxter: Do you like it?" he yells into a speakerphone to a r search associate. "How about financials?" "I want more r search on Miller Petroleum. I want to flood the place wit everything that's not right about Miller." "Peru is really th next Chile. But I can't do Peru and China—that sends a reck less signal."

Now it's 1:50 p.m. Cramer is recording his daily WOR radio show in a tiny closet in the bowels of the CNBC building. Onc

Cramer: The Man and his Picks

Slide Show: The many moods of Jim Cramer: From mad to manic—and everything in between

Picks of the Week Report Card: A look at how all his *Mad Money* selections have performed

The story on the Cover Story: For a podcast interview with Wall Street editor Roben Farzad by Executive Editor John Byrne, go to businessweek.com/search/podcasting/.htm

BusinessWeek online

http://www.businessweek.com/extras

JAMES J. CRAMER

BORN Feb. 10, 1955, in Wyndmoor, Pa., a Philadelphia suburb. Father a box and bag wholesaler; mother a sculptor.

EDUCATION Bachelor's degree in government, magna cum laude, Harvard College, 1977 (above). JD, Harvard Law School, 1984.

FIRST JOB Hawked ice cream and sodas at Philadelphia Phillies games.

JOURNALISTIC CRED *The Harvard Crimson, Tallahassee Democrat, Los Angeles Herald Examiner,* and others. Helped launch *SmartMoney* and *The American Lawyer.*

STREET CRED While homeless, he was mistakenly stopped and held for an armed robbery.

(WALL) STREET CRED High-net worth broker at Goldman Sachs, 1984 to 1987; manager of his $450 million hedge fund Cramer Berkowitz. His 15.4% stake in TheStreet.com was briefly worth $365 million at the height of the dot-com frenzy; it's now worth $15 million, but he has never sold a share.

CRAMER'S HUMAN RESOURCES HINT If you were serious about interviewing for a job at his hedge fund, you had to first show up with a box of hot Krispy Kreme donuts at 4 a.m.

TO RELAX He coached youth soccer until 2003; now grows beefsteak tomatoes and goes fishing at his country house in rural New Jersey.

HARVARD LAW Cramer with Eliot Spitzer, Cliff Sloan, and Alan Dershowitz in 1984

WEEKEND WHEELS A VW Beetle.

WHAT HE WATCHES *24, Law & Order;* made a cameo as himself on Fox's *Arrested Development.*

FAMILY Wife Karen, his former trading partner, and two daughters, Cece, 14, and Emma, 11.

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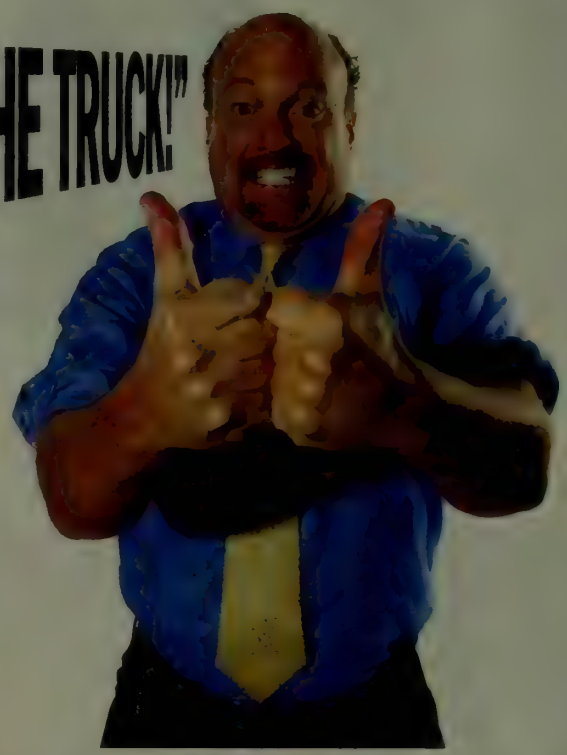
again, he's surrounded by flickering Bloomberg terminals. "5,4,3,2,1. The brokers are ridiculously oversold!," he screams. "More in a moment." During the break, he takes off his headphones. "This pump story," he says, "I'm booking the CEO of I-Flow tonight. I don't feel like recommending the stock, but this Baxter news is a fabulous opportunity for another player." After Steve Miller's song *Take the Money and Run* leads into his next segment, he tells listeners: "I think I can give you information and help build your confidence." After taking several calls and answering a widower's e-mail, he takes the headphones off again. He has just recommended shares in Goldman—his old stomping ground. "I got sophisticated at Goldman," he says, tapping the side of his head. "So-phis-ti-ca-ted."

Soon, Cramer is again marching down the hall in his sagging pants. With 75 minutes until *Mad Money*'s taping, it's time for makeup. He squints while the circles under his eyes get powdered. A ruff of paper towels protruding from his collar makes him look like a circus clown. "I'm glad I got out of Comcast at a profit," he says, as its ticker rolls past on the TV screen above. True to form—one look from his exasperated makeup woman confirms as much—Cramer just can't shut up. "Refco was a false blowup," he babbles. "This is not Long-Term Capital."

"BACK UP THE TRUCK!"



Already 13 hours into his workday, Cramer seems no less a workaholic than he was during his reign of terror at Cramer Berkowitz, where he frequently hurled water bottles at associates and smashed keyboards. He even told his partner, Jeff Berkowitz, that he had no business at his daughter's school play when Intel was about to report its results.

He takes a breather to talk about the impact of his obsessiveness on his family. After a catastrophic 1998 that nearly sank Cramer Berkowitz, the fund netted clients 47% in 1999 and 28% in 2000. "I was killing the market when everyone else was doing badly, and yet I was more miserable than ever," he says. His elder daughter didn't want to be around him, resenting him for being constantly leashed to his investors by phone. "All I did was say, 'Be quiet. Please leave Daddy alone. Daddy has to trade.'"

In 2000, Cramer's wife, Karen, gave him an ultimatum: Slow down, or else. She had been a partner at his hedge fund. He still affectionately calls her his "trading goddess" for persuading him to sell out before the 1987 crash and buy into the October, 1998, panic. (She declined to comment for this story.)

The tipping point came just before Thanksgiving, 2000, on a trip to Las Vegas with his dad. After ignoring his dad to call in orders to his fund for hours, Cramer suddenly turned to him and said they were clear to go to dinner. His dad exploded: "'You're 46 years old, and this is what you're doing?'" Cramer recounts. "'You don't care about anything but the fund. How can you be so miserable?'"

Cramer says the incident forced him to rethink his life. L er, he cashed out of the fund, handing full control to J Berkowitz. "Easy come, easy go," Cramer says, with a cl These days, his daughter's morning carpool is his top priori "I never miss," he says. "It's inviolate." On weekends, Cram tends to his garden's beefsteak tomatoes and chili peppers a digs night crawlers for bass fishing at his country house.

But for now, the obsessive stock lunatic version of J Cramer is wanted in the studio. Producer Krakower is paci and gorging on popcorn; Cramer is sipping tea. The crew is s ting up the remains of the chair he smashed the night befo one leg of which cracked a glass panel on a studio wall.

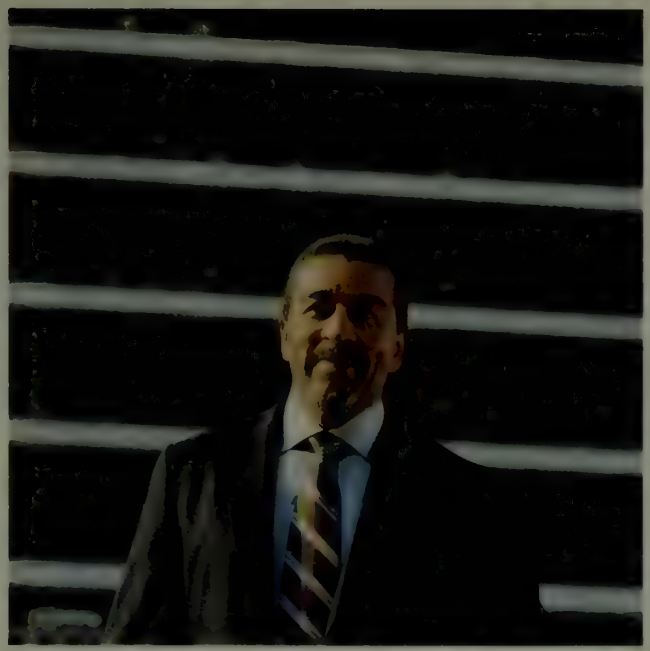
THE CAMERAS ROLL. Cramer hits a button, and haunted voice from above yells, "the house of pain!" to cue cameramen to run to the right. From Cramer's cartoonis sound-effects console comes the roar of a bull. "O.K., hor gamers, listen up: This is what the bottom looks like!" hollers through a megaphone. "You need to start buying 'cau stocks are going to rise!" he says, later adding: "The Fed's j which is to kill the economy, is almo done! Pretty soon Greenspan is goi to be in Sunrise Senior Living."

Cramer explains that because t ratio between ordinary investors a pros who've sold stock short—one his favorite contrarian indicators— at a five-year high, the moment is ri to buy. To drive home the point, goes full throttle with his effects from machine gun fire to crashi bowling pins to barking dogs, and hideous clip of a screaming man f ing out of a glass building.

After a commercial break, viewe who have been holding the line for long as an hour finally get to talk Cramer. "Let's go to Ashley fro Georgia," he says. "A big boo-yo hoooya to ya, Jim!" she drawls. "I heavily invested in oil, and it's bee very bad the last 10 days. I'm wonde ing: Are we gonna get hit again Cramer signals his continued bullis ness wordlessly by hitting his load-u the-truck button. Another chair hi the wall, as Cramer goes through 25 calls in his lightning roun in which viewers get a few seconds to ask his view on a stoc "Investing in Citibank is like investing in a Sunday school ethi class!" he tells one. "Schwab!" He slams his fist into his Buy bu ton four times. "Am I making myself clear?"

The show closes on a calmer note with the CEO of I-Flow o the phone for 105 seconds on the hot seat. "Sir," Cramer ask "do we have an opportunity for you to take [market] share wi the Baxter recall? Do you not sell products in similar situa tions?" The CEO guardedly agrees, and Cramer gives I-Flow halfhearted endorsement: "It's O.K., it's not great."

Even so, the stock's message boards are already abuz "Cramer seemed positive toward IFLO [sic] so we may g some volume & positive action next week," says a user at 7:0 p.m. "This pump," Cramer mumbles to himself, shaking h head as he exits the studio, hoarse, red-faced, and soaking.



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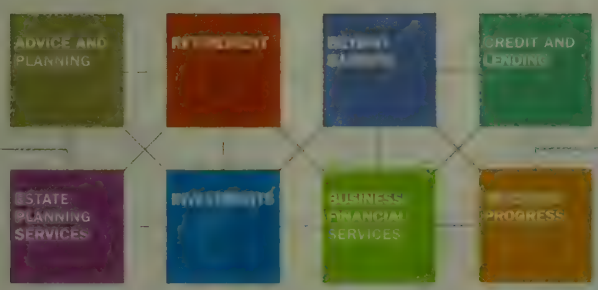

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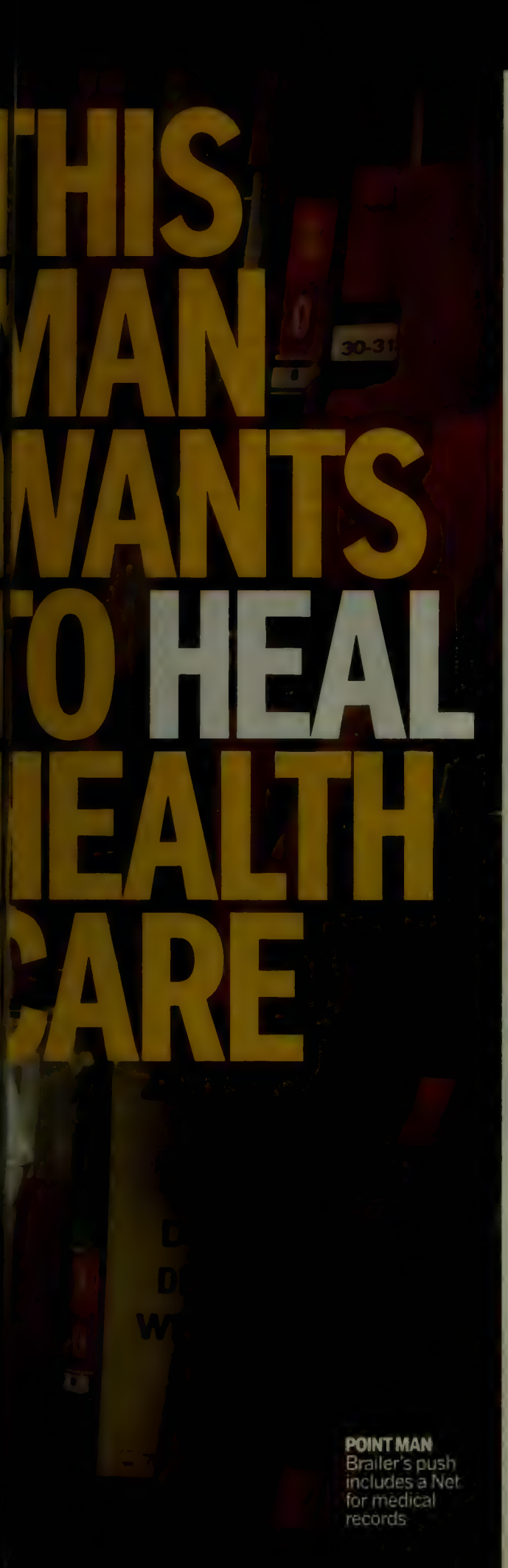
SPECIAL REPORT

THIS MAN WANTS TO HEAL HEALTH CARE



POINT MAN Brailer's push includes a Net for medical records

RICHARD MORGENSTEIN

David Brailer's job is to sell Bush's plan for rewiring American medicine. If he can, it could save lives—and hundreds of billions of dollars

BY TIMOTHY J. MULLANEY

DAVID J. BRAILER NEVER REALLY SOUGHT THE SPOTLIGHT. Yet here he is in Harrisburg, Pa., on a hot July day in a Hilton ballroom in front of 500 physicians. The 46-year-old doctor is the chief evangelist for President George W. Bush's effort to remake the $1.9 trillion U.S. health-care business by using information technology to save money and lives. In town to persuade physicians to join his cause, Brailer starts off with what's wrong with the current system. Medical errors, which cause as many as 195,000 deaths a year, are "an unmitigated epidemic," he says. Americans spend 16% of gross domestic product on health care, 60% more than Europeans, for mediocre results. And health insurance costs have resumed double-digit price surges after slowing in the 1990s. "Everyone knows someone who's had a bad experience in health care," Brailer says.

Then he switches gears. With the deft delivery of the software-company CEO he once was, Brailer begins to spin a vision of health care transformed. Technology, he says, can help doctors and hospitals invent new ways to care for patients that are safer, more effective, and cheaper. Health care can be reengineered just like U.S. manufacturing was. Thousands of lives, billions of dollars can be saved. He tells the docs it's up to them: "This is a groundswell that has a chance because it's not being done by just one of us. It's being done by all of us together."

When he finishes, the applause is warm and sustained. A parade of questioners ends with a brown-haired woman, pushing a fat notebook toward him. "Can I have your autograph?"

For years, U.S. health care has fostered something approaching a consensus of futility. Ask a doctor, patient, or insurer about the current system, and they'll rattle off a long list of complaints. The doctors and medical technology that go into American medicine may be the best in the world, but the care that comes out the other side is beset by woeful inefficiency, dizzying bureaucracy, and enough mistakes to make medical error the third-leading cause of death, behind heart disease and cancer. Reform efforts resemble the Middle East peace process: There's always a plan to make things better, but years later the fighting is still going on.

OBSCURE POST, SWEEPING TASK

NOW BRAILER IS ON a nationwide tour to attempt the most far-reaching reform in generations. He has taken his message to 40 states since Bush hired him in May, 2004, putting his issue and himself on the map. His post is an obscure one, national coordinator for Health Information Technology in the Health & Human Services Dept. Yet his task is sweeping: Give every American an electronic record of their health care by 2014, and link all the records into one giant medical Internet, called the National Health Information Network Inc. (NHIN). Brailer and his crew will build the network's backbone and set the standards for

Brailer's goal: Give every American an electron

swapping data. Doctors and hospitals will have to pay for the computers, software, and other gear to connect to the network, a total tab estimated at up to $150 billion over five years.

People have talked for years about what would happen if hospitals used more computers. With Brailer's plan, the focus is shifting to what happens when those computers are hooked together. Supporters say the network should save tens of thousands of lives by speeding up the flow of information—and innovation—through the industry. Doctors could easily see what drugs you're taking and not give you another that could cause a dangerous interaction. Researchers would be able to sift vast amounts of patient data to accelerate adoption of promising new treatments or spot dangerous drugs faster. "It has the potential to be the biggest advance in medicine since scientific method," says Brent C. James, executive director of the Institute for Healthcare Delivery Research in Salt Lake City.

Brailer could be dismissed as just another dreamer, except that his construction project is under way. His office gave out the first NHIN contracts on Oct. 6. Health & Human Services Secretary Michael O. Leavitt is expected to award contracts by Oct. 25 for building six networks linking communities of doctors and hospitals. Those will be the prototypes for the web of regional and specialty-interest networks the national network will tie together.

His campaign also has broad bipartisan support, a rarity in Washington these days. About a dozen bills promoting e-health initiatives are before Congress, including a joint effort by Senate GOP leader Bill Frist of Tennessee and Democratic Senator Hillary Clinton of New York. One key reason: Experts believe tech can easily shave $120 billion a year from health-care costs by eliminating duplicate tests, shortening hospitals stays, and improving care for chronically ill patients. Savings estimates run as high as $600 billion a year, or nearly the gross state product of Florida. There's even talk the savings could help bail out Medicare, which is expected to see its hospital insurance trust fund run dry by 2020. "It's a key part of saving Medicare," says Leavitt.

Still, the challenges to realizing Brailer's vision are immense. He's essentially trying to impose the kind of total quality management approach used by General Electric Co. and Toyota Motor Corp. on one of the most chaotic and complex sectors of the economy. Yet he lacks the control or resources of a CEO.

Paying for the network will be the first major hurdle. Many cash-strapped hospitals and small-practice doctors have no interest in footing the bill for a medical Internet. One key reason is the mismatch between costs and savings: While health-care providers bear the cost of tech investments, Medicare and private insurers reap almost all the savings. Pamela R. Kushner, a family medicine physician in Long Beach, Calif., says the estimated expense to upgrade her three-doctor office is $130,000. "I'm supposed to take the burn for the initial outlay, the installation, and the transition? No, thank you," Kushner says.

Patients may stop Brailer in his tracks, too. The idea of digitizing personal medical files and networking them has privacy advocates skittish. While the NHIN is being designed with the latest safeguards, hackers have shown the ability to penetrate almost every corner of the digital world. Of the 174 consumers who filed public comments with HHS about Brailer's network, 85% expressed concerns over a loss of privacy.

Patients may also object to the network's potential to restrict their health-care choices and raise their costs. One long-term NHIN goal is to identify treatments that work best and get all doctors to use them. That could mean physicians won't be able to give patients the care they would choose first. Another goal is for the network to promote Health Savings Accounts, which let workers put aside dollars tax-free for health care if they accept high-deductible insurance. HSAs are supposed to give consumers the financial incentive to demand better-quality care. But HSAs make workers pay a higher percentage of their health expenses—and critics fear they'll make poor patients skimp on basic care. Americans could end up asking the same question Brailer faced when *BusinessWeek* sat in on his private briefing of top congressional staffers in August: "Is this managed care in disguise?"

One reason the health-care network is racing forward anyway is the impact Brailer has on doctors and politicians in speeches like the one in Harrisburg. He's slick and funny, joking that he came because the state medical society was holding his mother hostage. The audience ate it up—especially Grace Brailer, an 80-year-old retired nurse who was in the crowd. His brutal travel pace impresses people: In October alone, he's due to hit 11 states

HOW BRAILER PLANS TO CHANGE HEALTH CARE

Health-technology czar David Brailer is behind the National Health Information Network, which is being designed to store electronic health records for every American and allow unprecedented tracking of medical care and results. Some of what it is expected to do:

dical record—and link every last one together

ut for Brailer, the effort isn't just professional. Something he leaves out of the smooth speeches pushes him to live on es and work 3,000 miles from his San Francisco home. It's nemory of his father. Ambrose Brailer died after a drug com- ation just like those David's network is supposed to prevent.

AJOR REEVALUATION"

R YEARS AGO the issues this coolly intellectual doctor had lied since med school became cruelly personal. Ambrose had Parkinson's for years. Then in 2001, the 77-year-old enough heart medication and blood thinner to cause in- al bleeding and heart rhythm irregularities. The overdoses e detected only after he was admitted to the hospital. he end was not kind. In his last days, Ambrose believed pur- people were talking to him, David's brother, Dan, says.

U SAFER Medical errors kill as many as 195,000 people in the U.S. per year. The NHIN is supposed e thousands of these by providing better, more timely information to doctors and hospitals.

QUALITY, NOT QUANTITY, OF CARE Today doctors typically get rewarded for the number of s or tests they conduct. One goal of the NHIN is to measure quality by tracking infection rates, ons, and other factors, and then let insurers reward doctors and hospitals for the quality of their care.

LTH-CARE EXPENSES The NHIN has won bipartisan support in Washington because it's to slash medical inflation. By reducing duplicative tests and medical complications the network e at least $80 billion to $160 billion in annual costs, most experts say.

CH INVESTMENTS To cut costs and improve care, hospitals and doctors will have to invest in on technology and connect to the NHIN. While that will cost $150 billion or more, the ent won't be picking up the tab.

U PAY MORE OF YOUR MEDICAL BILLS Brailer's network is designed to promote Health ccounts, a recent Bush Administration initiative that lets workers put aside dollars tax-free for e if they accept high-deductible insurance. The idea is that workers will shop around more for nd hospitals if they pay more of the bill.

YOUR CHOICE OF CARE OPTIONS Insurers and hospitals plan to use data from the NHIN to the best regime of care for each condition—and then pressure docs to use the best practices. mple: Utah's Intermountain Healthcare cracked down on induced births after data from its etwork tied early inductions to a higher risk of a stay in neonatal intensive care.

id believes his dad lost three or four years, time that he ned Ambrose had spent with David's own son, born just a months before. Brailer would not name the doctors in- ed, but he's still upset. "What bothered me most was the at- de: 'He's an old guy, he has Parkinson's, things happen,'" iler says, sitting in his Capitol Hill office. In an e-mail later, dds: "It did cause a major reevaluation of what I really be- ed in and what I was doing about it."

What Brailer believes in is an even more capitalistic version of erican medicine than today's system. He says what medicine ds most isn't more government aid or, heaven forbid, liber- dream of a single-payer system like Canada's or Britain's. nstead, he says the current health-care system can be saved l the participants have the reliable, timely information they d to make wise choices. This will come, he believes, from the a generated and dissected by his network. Insurers will be e to pay doctors and hospitals for performance, rewarding quality care and slashing complications. Consumers will have quantifiable ways to judge their doctors and shift business to the best performers. Since they'll be paying more of the bill, they'll also seek out good prices. And hospitals and doctors will see how they stack up for the first time. Then they'll either mend their ways or close their doors. "The network is kind of a Trojan horse," Brailer says. "There's a restructuring that happens when the consumer has real authority. Whole lines of therapy may disappear because people don't want them any more."

This approach is an easy sell to U.S. executives. A bevy of CEOs have lined up with Brailer to promote e-health, including PepsiCo's Steven S. Reinemund, FedEx's Frederick W. Smith, and Verizon Communications' Ivan G. Seidenberg. "This is the No. 1 issue for many CEOs," says John Chambers, CEO of networking giant Cisco Systems Inc. "Health-care costs are going up so rapidly. Society can't afford it. You've seen a change in philosophy. The country has the political will to support this."

While health-care providers have mixed feelings, some of the top hospitals and large-practice docs are joining the effort. Health-care providers have started more than 100 info-sharing networks around the country, though they're not standardized and don't connect to each other. Among the latest: a plan announced on Oct. 3 to connect 20 San Diego hospitals, 375 pharmacies, and 7,000 doctors. "What Brailer's proposing is very expensive in the short run, but will undoubtedly have major savings in the long run," says Stephen H. Carson, medical director of the San Diego County Medical Society.

But employees may be harder to convince. The skepticism goes beyond the issues they'll confront if Brailer's system works. Some labor leaders, including Service Employees International Union President Andrew L. Stern, doubt Brailer's system will work at all. Stern says most workers lack the skills—and the desire—to analyze data and make decisions about costs and quality. He also predicts employers will keep the savings. "One would think they would try to prove a theory this radical in a single state, as opposed to changing the whole health-care system based on ideology," says Stern.

Brailer has spent all his life preparing for this moment. The path began in Kingwood, a coal-mining town of 2,900 in northeastern West Virginia. Grace, opinionated and outgoing, worked as a surgical nurse in the local hospital, where she still sits on the board of directors. The low-key Ambrose was a coal miner and later a maintenance supervisor. David is the third of four kids.

From an early age, he attracted mentors the way Elvis Presley drew girls, says his brother Dan. The most important was David Z. Morgan, a dean at West Virginia University School of Medicine in Morgantown, where Brailer studied medicine. "DZ" was from

The savings estimates range up to $600 billion a year

Kingwood, too, and had gone to high school with David's father. Morgan, now 80, says he used long chats with Brailer to press his view that doctors couldn't serve patients unless they communicated better. Morgan pushed him toward bigger things: He helped his protégé become the first student trustee of the American Medical Assn., then recommended him for a fellowship at the University of Pennsylvania's medical school. "When David got exposed to DZ, he got excited about helping more people than an individual doctor can," says med school classmate Dan Martich.

As Brailer was finishing his medical training at Penn, he also earned a PhD in economics at The Wharton School. He was shocked by the divide between the two fields. In his economics studies, he read up on Total Quality Management, imbibing the teachings of quality guru W. Edwards Deming, who argued that careful planning and coherent organization would let companies make complex products with virtually zero defects. Then he would go back to the hospital and see some interns make mistake after mistake. "It was horrible quality," he says. "But families would still come up and thank us for doing so well."

The economist in Brailer came to see medicine as driven by incentives that bred complacency, if not greed. Insurers, especially Medicare, subsidized sloppiness by paying for good and bad care alike: In fact, since Medicare paid to treat complications from mistakes, it actually paid more for bad care. Hospitals were no better. Brailer's 1992 economics dissertation was about hospitals deliberately letting quality slide when they were crowded to protect profit margins. "Doctors don't get pai to do the right thing," he says. "They get punished."

But when he decided to do something about it, Brailer su prised his professors. Instead of staying in academia, he star ed a company. To write his thesis, Brailer had invented ways measure health-care quality. He turned those into CareScien Inc., a Philadelphia software firm that helped hospitals impro efficiency and prevent errors. The company went public 2000, but sales stagnated at less than $20 million. The boa decided to sell, over Brailer's objections. Still, it made him fai ly rich—his stock was worth $5 million when he left in 2003

SOARING EXPECTATIONS

AS CARESCIENCE BEGAN to seek a buyer, Brailer had a Will Sutton-esque epiphany: To solve medicine's quality problems, had to follow the money. The government buys nearly half of th nation's health care, and its policies for reimbursing care disto the whole market, he thought. He was first hired as a consulta to the White House and then tapped to lead the NHIN effort.

Just over a year in his government job, Brailer wrestles wi rising expectations. Estimates of the potential health-care sa ings from IT have been skyrocketing. Most started at betwee $80 billion to $120 billion a year. But early this year, a group CEOs organized by Brailer's office, including FedEx's Smith an PepsiCo's Reinemund, put potential gains at as much as 30% U.S. health-care spending. That's where the astonishing $60 billion figure comes from.

What would it take to cut all th spending? The first $100 billion may a tually be pretty easy. Two studies—o in January by the Center for Inform tion Technology Leadership at Harva University and one by the RAND Co in September—calculated annual sa ings of $81 billion to $122 billion by t middle of next decade. These amoun represent savings mostly from cuttin out simple things like duplicate tes Doctors often order up X-rays or C scans for patients even if they recent have had similar tests somewhere el because it takes too long to get a copy earlier results. CITL Chairman D Blackford Middleton says about 20% hospital radiology tests are duplicate "What we did to get to these numbers very conservative," Middleton says.

The next $80 billion to $100 billio in savings would come from using tec nology to manage chronic diseases be ter. Patients with problems like diabet and asthma are crucial e-health targe because they use a third of America health-care spending. RAND says takin better care of them can slash at lea $81 billion a year. With new softwa and better databases, insurers would b able to identify chronic disease patien and attract them into early-interventio

BIO

DAVID J. BRAILER

He realized early on that there were limits to how much an individual doctor could do—and he wanted to do more

BORN July 16, 1959 in Kingwood, W. Va.

EDUCATION M.D., West Virginia University; PhD in economics, University of Pennsylvania's Wharton School.

JOB As National Coordinator of Health Care IT, in the Health & Human Services Dept., he's leading the effort to give every American an electronic health record—and persuade doctors and hospitals to invest in the technology they need to connect to the network.

PERSONAL STAKE Father died after a drug complication like those Brailer's health-info network is designed to prevent.

FAMILY Lives in San Francisco with partner Dr. Matthew Rhoa, a Genentech researcher, and 4-year-old son.

KEY TRAINING His doctoral thesis was on how to measure the quality of care in the medical field. He used those ideas to found a software startup, CareScience, that helped hospitals measure results. It went public in 2000, and Brailer made about $5 million when the company was sold.

WORK ETHIC One motto in Brailer's office: "We work like dogs; we travel like animals." One staffer's wife e-mails Brailer directly to tell him when her husband needs to make family events.

HOW HEALTH CARE GOT SO BROKEN "I blame the government. Doctors don't get paid to do the right thing. They get punished."

The Right Mix

Improve customer service by ıtegrating Web, phone, fax and e-mail.

STRATEGIC USE of customer service today is considered the le most significant tool in retaining current customers and in- sing revenue from the critical installed base. "Service is really way that customers think about all of their interactions with a pany," says Claire Gribbin, vice president of global customer cacy at Cambridge, Mass.-based ATG Inc. (**http://www.atg.com**), h supplies software to create a more relevant and consistent omer experience. "That makes it the best way to turn it into ategic driver for your company."

tegrating customer interaction information—from the Web, hone, e-mail and other approaches—may be a technologi- challenge, but it pays big dividends by providing cross-sell ortunities while improving overall service to the customer. "It spam if an e-mail actually contains information useful to your omer," says Tim Crowder, senior program manager for knowl- e management at ATG customer Symantec o. "We are applying our expertise derived n using ATG's eCommerce and marketing forms to the service and support arena. Now, it is possible to individually tailor the millions of interactions we have to meet an individual customer's specific needs at the point of service delivery. High tech is now truly delivering high touch relationships."

Beyond cross-sell and upsell possibilities, new customer acquisition costs are soaring, so keeping customers loyal is more strategic than ever. "The best way to do that is by leveraging what you know about your customer—what products of yours they own, how they have interacted with you across all channels—to serve them in a way that opens opportunities for you as well," Gribbin says.

Properly executed customer service can also increase revenue because satisfied customers tend to engage in profitable "word of mouth," which may result in new customers. "Everything is so commoditized that the biggest opportunity is to build on what you know about your customers and your relationships with them to provide truly differentiated offerings," she says. "Service is the crux of that."

The strategy of increasing customer retention through education exemplifies forward thinking in customer service, says J.B. Wood, president and CEO of the Service & Support Professionals Association in San Diego. "Companies spend all this money to build out features in products," he says. "At the end of the day, it is my ability to be able to use those features that will determine how successful and satisfied I am as a customer." ■

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In Brailer's future, quality rises, patient choice falls

programs, with computer-generated reminders to both doctors and patients to take preventive steps.

But to get the final $400 billion a year in savings, medical care would have to change radically. Insurance companies want to use Brailer's network to standardize care—they believe guiding consumers to care that research says is best will boost quality and save money. The term for this is evidence-based care: Translated, it means use the data to find out which treatment is best, and then insist everyone use it.

Unexplained variations in care add hundreds of billions a year to America's health bill. They're especially dramatic among senior citizens. John Wennberg, director of the Center for Evaluative Clinical Services at Dartmouth Medical School, has spent years working with Medicare data to show that doctors in high-cost cities like Miami spend nearly three times as much per patient as doctors in low-cost cities such as Minneapolis. Worse, Wennberg contends Miamians don't get better results. He says spending in high-cost cities spikes because they have more specialists, testing facilities, and hospitals. "If the supply is big, people will sell you something quick," agrees Florida State University geriatrics professor Kenneth Brummel-Smith.

One way Brailer and others expect to squeeze out these kinds of waste is pay for performance. The idea is that insurers will r ward hospitals and doctors for good care, measured by the ra of complications or adherence to strict treatment protocols. T government, primarily through Medicare, is leading t charge. Medicare is conducting a trial with more than 270 ho pitals in which the top 20% in quality get bonuses and po performers could see payments trimmed up to 2%. Legislatio is pending in Congress to take this trial nationwide.

BACKLASH POTENTIAL

BUT PUSHING HEALTH-CARE reform very far in this directio could result in a serious backlash. Marcy Zwelling, a 52-yea old solo practitioner in internal medicine in Los Alamitos, Cali just south of Los Angeles, is openly skeptical. "This gover ment, all they want is another way to judge me, to penalize me she says. "It's absolutely a ruse." She says government mea ures of quality are typically overly rigid, which likely will resu in doctors performing too many unnecessary tests. "I have 8 year-old patients who simply don't need mammograms, bu get dinged when they don't get mammograms," she says. "I one of those old doctors who likes to take care of people."

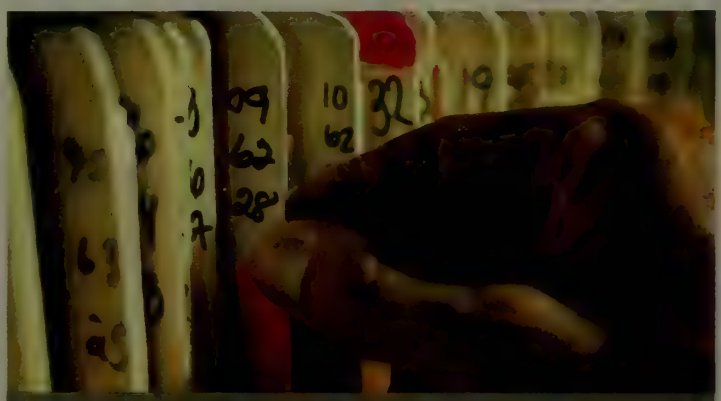
Consumers almost certainly will have less choice, too—t attribute of America's health-care system they like best. The are signs of this already: At Intermountain Healthcare, a 2 hospital system in Utah, researchers found that babies healthy mothers who were induced before week 39 of pre nancy are more likely to need intensive care. So Intermountai discourages such inducements. Its elective inducement rate about 5%, compared with 30% nationwide.

Fear of offending both doctors and patients is why most i surers plan to move slowly in exploiting data from tech system Private insurers like Wellpoint Inc. and UnitedHealth Grou say they won't use data from NHIN to decide not to cover sp cific kinds of care. Instead, they plan to use the network to lo by professional associations like The American Geriatrics Soc ety. The idea is to show data to associations and get them to d the dirty work of telling doctors they have to change practic patterns. "It's not our job to make decisions for them," sa UnitedHealth Senior Vice-President Reed V. Tuckson.

There's no way to know exactly how much Brailer's natio al health network will shake up medicine. Though he expects t be done laying the NHIN's foundation before the end of th Bush Administration, he says the full effects won't be felt for 2 years. Lately Brailer is trying to tamp down expectations, a though the economist in him wants to save billions of dollars

The country doctor in Brailer, nurtured back in Kingwoo has more modest goals. Brailer tells the story of a childhoo friend with leukemia, diagnosed a few months after Brailer dad died. The friend, who asked not to be named, says Braile dropped everything to drive five hours to his side. Brailer tol him one key thing: Keep records of everything. Share them wit your doctors. It's the only way you can make sure your docto never has to make a decision without all the facts, he said.

Today, the friend totes notebooks full of data that Brailer want every patient to have—every test result, every lab workup—t each of his doctors at every visit. The friend is in remission. looks as if he'll never know the haphazard care that Brailer be lieves his father got. "He has the best personal health records I'v ever seen," he says. "And he has saved his own life 100 times."

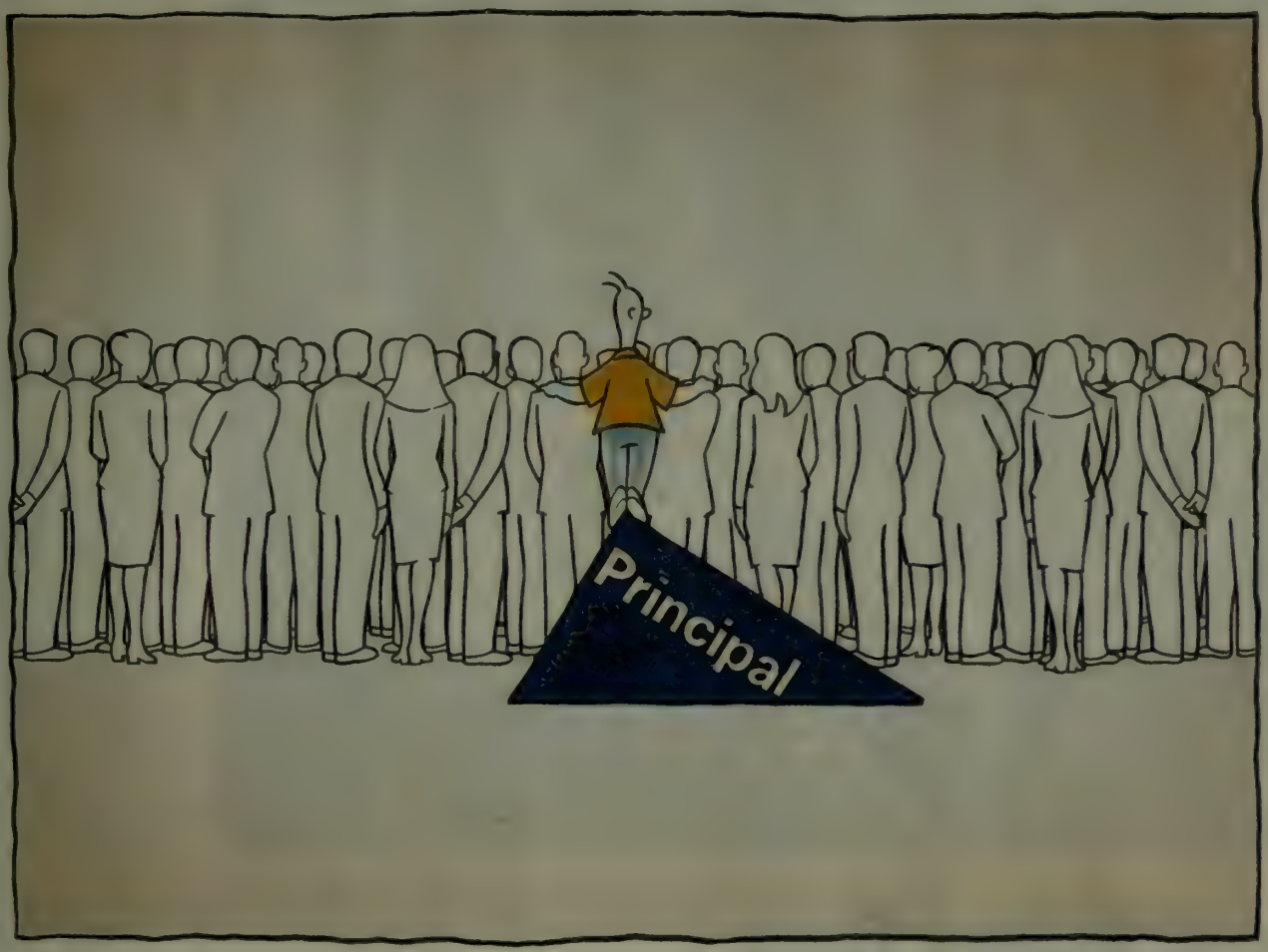


THE PROGNOSIS FOR E-HEALTH PRIVACY

BY TIMOTHY J. MULLANEY

David J. Brailer, the Bush Administration's health-technology czar, is planning to build a medical Internet that will hold all your health records. The biggest question consumers have about the project is whether those records will be safe from prying eyes. Brailer, with help from top tech companies, is developing sophisticated technology aimed at keeping people's privacy protected. Yet the credit-card companies and online retailers that promised tight security have seen their systems repeatedly penetrated by determined hackers. How worried should you be about the security of your health-care records?

BusinessWeek online For the full text of this story and more on e-health initiatives, go to www.businessweek.com/extras



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UNEVEN RECORD Investors got burned by a previous venture of Litvack's

Crashing the Stent Party

Conor Medsystems is trying to take on Goliaths J&J and Boston Scientific

CONOR MEDSYSTEMS Inc. is developing a new breed of stent that may have the power to swipe large swaths of business from rivals such as Johnson & Johnson and Boston Scientific Corp. But the company's chief executive officer, Dr. Frank Litvack, has a controversial past, and there are thorny questions about potential conflicts of interest and litigation that could torpedo its fortunes.

Stents, especially the ones that are coated with drugs to prevent blockage by scar tissue, are one of the most lucrative areas of medicine. The market for such "drug-eluting" devices is expected to reach $5.1 billion by the end of this year, up from $3.9 billion in 2004, according to CIBC World Markets Corp.

J&J and Boston Scientific are the two gladiators in this field, but many physicians are keeping a close eye on Conor's product as well. Although the stent's rate of restenosis, or recurrence of arterial blockages, has been about the same as existing devices, some doctors say Conor's is easier to implant and may prove safer and more effective.

On Oct. 21, the Menlo Park (Calif.) company will release new data from clinical trials at a top cardiovascular meeting in Washington. "If it came out in the U.S. right now, the marke would swing," says D Dean Kereiakes, a profes sor of clinical medicine a Ohio State University wh is serving as a co-principa investigator for Conor' U.S. clinical trial.

Yet Conor's technolog is difficult to assess, in pa because some docto helping to evaluate the de vices have received stoc options from the compan Among the 14 doctors wh sit on Conor's scientifi advisory board and ar participating in clinica trials of its stent, three re ceived consulting fees an five have received option according to document obtained by *BusinessWeek*.

Such relationships are growing source of concern in the med ical-device industry, drawing increasin scrutiny from regulators and medica ethicists. Still, Wall Street is smitten wit Conor's potential. Last December th company went public at $13 a share, the soared to $23 for a market cap of near $800 million. Conor has virtually no rev enue and is not expected to make a prof until 2008, but CIBC analyst John J Calcagnini, who has a $26 price target o the stock, believes Conor can take 11% o the market by 2009.

TREADING CAREFULLY

BEFORE THAT HAPPENS, though, Cono must navigate a minefield. Its powerful ri vals vastly outspend the startup on re search and development. Its stent has no yet been approved in any market. An this February, Conor was sued for paten infringement in Europe by Vancouve (B.C.)-based Angiotech Pharmaceutical and Boston Scientific. An giotech licenses a dru called paclitaxel to Bosto Scientific that inhibits th growth of scar tissue. Cono uses the same drug in it clinical trials, but claims th way it incorporates and re leases the drug is novel an doesn't infringe on its rivals patents. Boston has not ye sued Conor in the U.S., bu if Conor tries to crack th

> Conor still has to navigate a legal minefield to prosper

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U.S. market, Boston is expected to do so. "We haven't even looked into other potential infringements on the catheter side," says Boston's chief technology officer, Fred A. Colen.

If Conor were to lose the patent lawsuit, it would be forced to start a new stent trial with another drug, which would delay commercialization by several years. Even if Conor's device receives government approval, there's no proof that its stent offers a clinical advantage. "There are a lot of potential advantages," says Dr. Jeffrey A. Brinker, a professor at the Johns Hopkins University School of Medicine. But how likely are they to be realized? "I don't know," Brinker says.

No one is claiming that doctors enlisted by Conor are intentionally skewing the data because of their stock options. Moreover, there is no Food & Drug Administration rule barring doctors who participate in clinical trials from obtaining compensation from a company whose devices they are evaluating. But many universities, medical organizations, and scientific conferences now require that doctors disclose these relationships.

According to the disclosure documents, five of the doctors who have received stock options are top cardiologists at Columbia University and Stanford University Medical Centers and the Scripps Clinic. The doctors named couldn't immediately be reached for comments.

Columbia, Stanford, and Scripps say that their doctors who are affiliated with Conor have not violated any rules, and Conor also says that it has done nothing improper. Company execs say they paid doctors for their expertise with options since, as a small startup, Conor had little cash.

It's difficult to specify the value of compensation that each doctor receives because Conor does not release that data. In their disclosures made to medical conferences, doctors must reveal the type of compensation they receive, such as stock ownership, but not its value.

In its financial filings, Conor said it granted options to purchase 1,137,750 shares of its stock—valued at $26 million—to "consultants and other nonemployee service providers." However, Conor says not all of those consultants are doctors. Some are contract workers, such as engineers.

Dr. Kereiakes of Ohio State receives airfare and several thousand dollars from Conor to attend meetings. But he sees no conflict, he says, because he is taking a hefty pay cut to devote time to Conor. Conor says it forbids lead investigators from receiving options, but Kereiakes and his co-investigator would not take them anyway because they say it would harm their credibility. "I would not embarrass myself and give a presentation when I have a million dollars in stock from a company," he says. "There's nobody in the world that would say that's not a conflict of interest."

Dr. Litvack's professional background has also attracted attention. Having served as co-director of the Cardiovascular Intervention Center at Los Angeles' Cedars-Sinai Medical Center from 1986 to 2000, he was recruited by Conor co-founder and Chief Technology Officer John F. Shanley to serve as CEO in the fall of 2001. But his track record as an entrepreneur is uneven. Litvack has helped run three companies, one of which was Advanced Interventional Systems Inc. The company developed laser technology to clear u tery blockages, but it lo patent infringement lawsu 1992 and never gained n traction with doctors. In 1 it was acquired by its chief Spectranetics Corp., for $12 million—a thin sliver of $150 million market ca reached after going pu in 1991.

Some doctors say the new stent is easier to insert

Is Frank Litvack headed a debacle like the one burned investors more than a dec ago? CIBC's Calcagnini scoffs at the i "That's old news," he says."People trying to detract from the idea that Co has a novel design."

At least two physicians with no fin cial ties to Conor give its device h marks. Today's leading drug-elut stents were designed as bare metal tu and the companies later added drug co ings. By contrast, Conor designed its st from the ground up to deliver drugs surrounding tissues. The idea co from Conor's Shanley, who used comp er-guided manufacturing techniques create hundreds of little wells for dru on the stent's lattice (table).

SLIPPERY SUCCESS

SOME CARDIOLOGISTS say Conor m succeed because its stent, which is th ner and less sticky than existing dru coated stents, is more easily maneuver through a clogged artery. "If everythi else was me-too, just that one featu would take the whole market," says Mitchell Krucoff, a professor of medici and cardiology at Duke University Me ical Center who is the co-principal inv tigator of Conor's U.S. clinical trial. Kr coff says he has received less th $10,000 in consulting fees from Conor

If current clinical trials go well, Eu pean regulators could approve Cono stent by yearend—and the FDA could f low by late 2007. Still, even with approv Conor must battle Boston Scientific, J and others. Boston Scientific is spendi more than $200 million a year on R for new stents and delivery systems—fo times what Conor has spent during its e tire six-year existence.

For Litvack, the key to beating the co petition is more innovation, both in d vices and drugs. Conor is now developi a stent that uses anti-clotting compoun acquired from Novartis. "We believe t job of a good medical company is to ma your products obsolete," he says. ■

–By Spencer E. Ante in New York, wi Amy Barrett in Philadelph

Doing Double Duty

Conor's devices are part of a new generation of stents designed from the get-go to deliver drugs while holding open an artery. Here's how:

The stent, dotted with hundreds of tiny wells filled with precise doses of drugs, is inserted into a clogged artery

One drug helps to fight the formation of scar tissue while the other is pumped into the bloodstream to help preserve heart muscle

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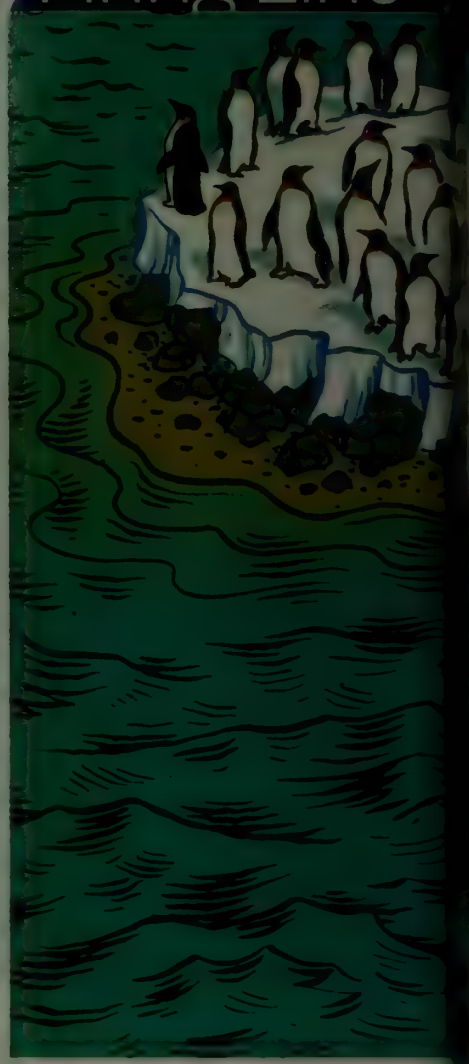
Cold Realities For Novell

CEO Messman is under attack as he tries to convert the company into a Linux power



IN THE FALL OF 2004, CHRIS Stone, then vice-chairman of Novell Inc., took a nine-week executive education course at Harvard Business School. Stone was considered a rising star at the software company. Several Novell insiders say they thought his Harvard stint was the final step in polishing his skills before he took over as chief executive from Jack L. Messman.

But Stone was in for rude surprise. As the course was wrapping up, he met with Messman, and the boss forced him to resign. Neither man will talk about the incident. But former Novell executives say the two had clashed several times previously over who should take credit for the company's decision to shift its focus to selling the Linux open-source operating system. Two sources close to the company say that disagreement was the primary reason for the final split.

The reverberations of that meeting are still being felt today. Earlier this year, investors privately expressed concerns about Messman's ability to retain key execs and manage operations. Then on Aug. 25, the Waltham (Mass.) company surprised Wall Street with a 90% decline in quarterly profits, to $2 million, and a 5% sales slide, to $290 million. Critics quickly went public with their concerns and began calling for change at the top. "I think ultimately fresh leadership is needed," says analyst Jason Maynard of Credit Suisse First Boston. Blum Capital, with a 5% stake in Novell, told the company in a letter that its strategy is sound, but "the question is whether the current management and board will execute."

TURNAROUND? Messman says Novell's revenue dip was a glitch

Change could come rapidly now. Novell insiders say the company plans to announce a major restructuring on Oct. 31 that will include layoffs of at least 20% of the 5,800-person workforce. Blum Capital is expected to wage a proxy battle for several seats on the board. The deadline for proxy measures is Oct. 27 and the entire board is up for reelection next April.

RED HOT RED HAT

MESSMAN SAYS he doesn't know what all the fuss is about. He told investors it would take two years to turn the company around, and that deadline isn't up until January. "It was complex," he says. "We had a lot to fix. I said it would take two years, and we're coming to the end of that." He dismisses the third-quarter miss as a one-time glitch and insists that the company is on the right track. Novell's board stands behind Messman, says director Richard L. Crandall: "Jack is a strong manager. He's the creator of this direction, and I don't know how you give him weak grades on leadership."

Messman may have the confidence of the board, but he still faces tremendous challenges. He's trying to create a new sort of company, selling a combination of traditional software and Linux software—called open-source because it's created and shared by an army of volunteer programmers. Yet former Novell managers say he has an autocratic, top-down management style that conflicts with the collaborative spirit of Linux and the open-source movement.

Marketing is tricky, too. The mixed message about two kinds of products is hard to convey to customers and has little appeal to those who aren't already committed to older Novell products. Novell is known for its server operating system NetWare, which has been losing ground to Microsoft's Windows and Linux. Unless Messman gets the strategy to click, Novell could resume the slow slide it was in before it picked up the Linux banner.

If Novell can't regain its footing, it could represent a major setback for Linux. The software has gained considerable traction in corporations, with nearly a 25% share of the server operating system market, according to market researcher IDC. Yet customers and the computer makers who back Linux want two strong Linux distributors. And right now Red Hat Inc. seems to be running away with the market. It had 63% of the Linux server market share in 2004, compared with just 20% for Novell. "We don't see Novell that much," says Timothy Yeaton, Red Hat's senior vice-president of worldwide marketing.

The worry is that Red Hat will become just as dominant in Linux as Microsoft has become with its Windows operating

stem. That would eliminate one of the k attractions of Linux, and may make corporate customers less willing to rely on the operating system for their servers. Even Novell's sharpest critics agree that going into the Linux business was the right move as open-source software emerged as a strong alternative to Microsoft's. The company bought Germany's SUSE Linux, and smaller desktop Linux company, Ximian, in 2003. Linux gave Novell a new product line to sell, and it put the company in the middle of one of the fastest-growing markets in technology.

But while the strategy was laudable, Messman's execution has been less so. It took 18 months to retool Novell's 1,100-strong North American salesforce so it could sell open-source software, and the company is only now focusing overseas. Analysts and ex-employees say Messman's management style has contributed to the departure of employees vital to making the Linux strategy work. In addition to Stone, the company lost former Chief Technology Officer Alan F. Nugent and former SUSE CEO Richard Seibt, who both resigned. Nugent and Stone are widely credited for Novell's Linux strategy. Messman sharply denies this. "I'm the guy who came up with the strategy," he says. Nugent says, "Jack had to be sold on the Linux strategy a number of times."

Novell says Messman has been an inclusive, rather than a divisive, manager. "Management has become more team-oriented and collaborative under Jack's leadership," says a spokesman.

LEARNING TO LISTEN

TO NUGENT AND other former insiders, Messman doesn't have the right stuff to run a Linux company. In April, 2003, just a few months before Novell's acquisitions, he alienated Linux developers by calling it an "immature operating system." At that point, Linux was widely used in corporations. After an outcry, Messman backpedaled with a public apology, saying Linux was capable of handling demanding computing tasks.

Messman's management of Novell's costs has been an issue too. It has a large campus in Provo, Utah, and headquarters in Waltham, Mass. There are the two corporate jets, which Messman says are necessary for flying customers to Waltham to meet with him. In contrast, Raleigh (N.C)-based Red Hat is so penny-pinching that its executives often take the subway rather than cabs when they're in Northeastern cities.

To Messman's credit, he is responding to some of the investor concerns. Novell has instituted a $200 million share buyback. And Messman agrees that the company can cut more costs and should sell off its consulting division, Celerant.

It's not too late for Messman to get the company back on track. Analysts praise Ronald W. Hovsepian, Novell's executive vice-president of worldwide field operations, who completed the salesforce makeover. He cut the number of products they were hawking from 300 to about 80. And he instituted a more aggressive sales culture. "We obviously had to change a lot of the DNA," Hovsepian says. Analysts see him as the new heir apparent to the corner office, thanks to a go-for-the-jugular style that Novell lacked in the past.

Will it be enough to shift Novell's direction? Maybe. A wild card is the support from computer makers Hewlett-Packard, Dell, and IBM. "There's a huge benefit to having two [Linux] suppliers. Customers have choice," says Scott Handy, IBM's vice-president of worldwide Linux. The three giants might push business Novell's way. With their help, Novell may yet turn into a leader again. For the sake of Linux, it better happen. For the sake of Messman, it better happen soon. ■

–By Sarah Lacy in San Mateo, Calif.

"THE JAPANESE AND THE FRENCH ARE SO DIFFERENT. HOW CAN THEY POSSIBLY FIND A COMMON GROUND?"

Toyota's Vice Chairman Fujio Cho says Toyota is enjoying great success in fusing its business methods with French values.

see next page

The PGA Tour: Sand Trap Ahead

As it negotiates new TV deals, the Tour finds itself in a weakened position

WHEN THE PGA Tour negotiated its last TV contract in 2001, Tiger-mania was in full scream, and ratings were soaring. Betting that pro golf was the next mainstream sport, networks and cable channels forked over a total of $850 million in rights fees between 2003 and 2006—a 50% hike over the preceding four-year deal.

Fast-forward to the present, and it's clear the TV executives took a bogey on those contracts. When Tiger Woods fell into a relative slump in 2003 and 2004, ratings for tournaments broadcast by the networks dropped from an average 3.6 in 2001 to 2.9 so far this year, according to Nielsen Media Research. As a result, ABC, NBC, and CBS are expected to lose collectively as much as $50 million on their golf contracts this year. And as the PGA Tour and TV execs begin negotiations in coming weeks on a new four-year deal beginning in 2007, the networks are threatening to trim coverage—including, possibly, a cut in rights fees. Speculation is rampant that ABC is considering a reduction in broadcasts of its fall golf events in hopes of landing a piece of the next NASCAR contract. An ABC executive says that no decision has been made.

But network executives, who asked not to be identified, are unanimous that something has to give. "The economics of golf have gotten all out of whack," fumes one TV sports chieftain. "I don't think any of the networks are going to air golf without a better sense they're going to make a profit."

However, Ed Moorhouse, co-chief operating officer of the PGA Tour, notes that it already has locked up title sponsors for more than 20 of its 42 tournaments through 2010. And since those contracts stipulate that roughly half of the sponsors' fees go toward buying ads on golf broadcasts, Tour officials say that—unlike other pro sports—they've already presold a big chunk of commercial spots for broadcasters. "I think the state of pro golf is fine," sa Moorhouse. "We st have the be business model any sport."

> The Tour says it has sponsors for over 20 out of 42 tourneys through 2010

TIGER TIME
Viewers seem to turn off when the champ slumps

The mere prospect of a cut in righ fees—which, in turn, could result in le prize money at some tournaments—prompting Tour officials to ma changes to their lineup. To mainta viewer interest as the season drags in fall, sources say the Tour may adopt variation of NASCAR's successful "Cha to the Championship." Under the pla players would spend the first two-thir of the season trying to earn points th qualify them for a three-tournam showdown in mid-August. Adopting points system could also entice top pr to play more events, ending the ratin drop that occurs when stars like Woo and Phil Mickelson begin scaling ba their schedules in early August.

THE NEVERENDING SEASON

STILL, SOME EXPERTS say the PGA Tou real problem is too many hours of go programming: Under the current sche ule, the Tour stages tournaments almo every weekend between January and ea November. Says Scott Seymour, seni vice-president for golf events at New Yo sports marketer Octagon Worldwide Lt "It's the season that never ends."

In response to such criticism, sourc say that PGA bigwigs are considerin moving the season-ending Tour Champ onship from November to mid-Septem ber, just about the time the NFL seaso starts to heat up. After that, sources s one plan would be a series of reduce purse events with fields made up large of second- and third-tier players scra bling to earn enough prize money to qu ify for a slot on the Tour in the followin year. But these late-season tourne could wind up on cable channels like US Network and the Golf Channel, whic would probably pay only a fraction o what the networks paid in the past.

Already, the prospect of a shakeup is sending tremors through the golf world particularly among smaller tourneys. "If you shorten the season, where are the opportunities for the younger players?" asks Jim Kline, tournament director for the Reno-Tahoe Open. Yet even Kline concedes that he tends to watch events "when Tiger's playing." ■

–By Dean Foust in Atlanta

BusinessWeek online For more on possible changes in the PGA Tour, please visit us online at www.businessweek.com/extras

Toyota's Vice Chairman Fujio Cho says France and Japan make a winning partnership.

"We've had fantastic support from the French. Great teamwork and a real understanding of the concept of 'continuous improvement'."

Has it been difficult adapting to the French way of doing things?

We have had no difficulty at all. At Toyota, our management philosophy is based on two pillars: mutual respect and what we Japanese call 'Kaizen', which means continuous improvement. We actively encourage our employees to suggest new ways that can improve our system. Because inventiveness comes naturally to the French, we've had no difficulty adapting the spirit of Kaizen to France. In fact, the employees at our factory in Valenciennes have developed a new technical vocabulary that fuses Japanese with French words. I think this is a good example of how we've achieved a good blend of French thinking and work styles with the core values of the Toyota Production System. It is thanks to the French people that our French business is so successful.

So what has French innovation brought to Toyota?

Our strategy is to manufacture vehicles where the market is. That means designing models that meet the high demands and tastes of European consumers. We chose to set up a design center in the south of France with a mission to develop cars that precisely fit the European market. Our design center in southern France has created the styling for key models like the Yaris (sold as the Vitz in Japan) and Corolla. In fact, the Yaris has won high acclaim not only in Europe, but also in many other markets around the world.

Are the French hard to work with?

The people of the Nord-Pas-de-Calais region where we built our plant have demonstrated outstanding teamwork and a Kaizen attitude that got production up to speed very smoothly. Our star-shaped factory, which was state-of-the-art when we built it in 1998, became operative very quickly; the result of the local people's tradition of high-level skills and workmanship which combined beautifully with the Toyota Production System.

Toyota in France

- [illegible]
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Has your joint venture with PSA Peugeot Citroen been a productive experience?

It has been a very challenging experience, in which both Japan and France have learned much from one another. There were differences in areas such as the stages of bringing plants on line and work procedures, but we overcame these. Our mutual strengths and weaknesses complement each other, and have created a good cooperative relationship for the future. It gives me great pleasure to know that we have been able to launch the Aygo, a car developed for the European market, as a concrete result of this partnership.

What do you find attractive about doing business in France?

France has a highly developed automotive industry and is an extremely important nation in Toyota's European strategy. It has a rich industrial infrastructure, numerous parts suppliers and a highly qualified workforce. And it is geographically in the center of Europe with a high quality transport infrastructure.

What has the Government done to help?

When we built the plant in 1998 the Government assigned a single dedicated person to handle all our negotiations. This streamlines decision making so that everything happens as quickly as possible. The French Government has been a huge help.

Toyota is the only Japanese car firm to manufacture in France. Have you ever felt any difficulty doing business here?

Absolutely not. After starting out in France as an importer, we've gone on to become an investor and now a full-scale industrial player. We design, engineer, manufacture and sell our cars here. We even have our own showroom on the Champs-Elysées.

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THE NEW FRANCE. WHERE THE SMART MONEY GOES.

Good Divorce, Good Business

Why more husband-and-wife teams keep working together after they split

NAPA PARTNERS Elaine and ex, Michael, still jointly run Honig Vineyard

THREE YEARS AG Elaine and Michael Hon celebrated their 15th we ding anniversary in $1,550 suite at New Yo City's Four Seasons hot Sprawled on the Rivol linens, they drank French champagne an ate chocolate-covered strawberries. Th Honigs had started their marriage makin sales calls for their wine business in a V diesel that lacked both air conditionin and an operable passenger door. Food wa Taco Bell burritos. Lodging was often $52-a-night dive with no sheets. So weekend ensconced in the I.M. Pei-de signed aerie—with its silk-padded wall remote-control blinds, and a deep-soak fills-in-60-seconds tub—should hav been the ultimate romantic restorativ Except that, says Elaine, "I felt like I wa lying next to my brother. Or my cousin."

The Honigs, with their Honig Vineyar & Winery, were one of Napa Valley's gold en couples. But privately, the weekend o anniversary luxe was a marital Hail Mar Elaine wanted to slow down and enjo their award-winning sauvignon blanc i their recently completed dream mans Michael preferred to travel 24-7 for bus ness, even making sales calls during th couple's nights out. Elaine wanted emo tional intimacy. Michael's cards include notes such as: "Dear Elaine, You're good egg. Love, Michael." She yearne for a child. For him, the business was th only baby he'd ever need. "It was like sh was telling me she wanted me to b taller," says Michael.

BOARDROOM MATCH

SO INSTEAD OF RAISING her glass o aromatic pinot blanc at lunch at Gothan Bar & Grill that weekend, Elaine lowere the boom. "I just don't think this is goin to work," she recalls telling Michael. Im mediately, she could see he was relieve and right there with her. What surprise her were the first words out of hi mouth: "You aren't going to leave th winery, are you?"

Clearly, the Honigs were a team in th boardroom if not the boudoir. Not wan ing to dissolve their highly functiona business partnership, they did what mor and more creative-class couples wh work together are doing: They went fo the newer, nicer ver sion of divorce—th good divorce.

Just as former part ners have been mor willing in recent year to remain friends s

y can co-parent their children, more buses-cum-colleagues are now willing remain friends so they can stay at the npany together. Good divorces are rowing by leaps and bounds," says nily attorney Lee S. Rosen of Rosen w Firm in Raleigh, N.C. Boomers and n Xers want none of the ugliness of ir parents' *War of the Roses*-style splits. e shifting career climate—in which the eat of a layoff has increased 49% since 1970s, while the chance of losing alth insurance has soared 150%—is o making many more leery about rting a new business or switching npanies or careers. Not to mention the r and loathing that globalization is eaking among the educated elite. Cou- that with the gruesome expense of di- rce—and a deeper awareness of its poi- nous emotional legacy, especially on ldren—and it makes sense that many rtners and co-workers, well versed in ice politics, are attempting to finesse a et along" breakup.

FICE ETIQUETTE

DAY THERE ARE more than 1.2 million sband-and-wife teams running com- nies together, according to the Nation- Federation of Independent Business. d a quarter of family businesses expe- nce a divorce. Across the corporate dscape, one study found that 10% of uples who divorce continue working to- her. That's not surprising given the quency of workplace romances, with arly 60% of workers admitting to hav- had an office relationship, up from % two years ago. Babette Chandraso- , a human resources manager in stin, Tex., of Eden Prairie (Minn.)- sed hearing-aid manufacturer Starkey, t both her current and former hus- nds at work. In fact, her ex works in a bicle 20 feet away. "We went through a ase where he would get a letter from a vyer and would want to talk about ngs at work," says Chandrasoma, who ares custody of her 11-year-old daugh- with him. "We had to make a deal that wouldn't talk about our rsonal business at the of- e."

Collaborative law, a owing legal movement at is shifting marital dis- tes away from sparring, vyer-directed affairs to ore healing, client- ntered ones, is also con- buting to the rise of good vorces. Many business ople, with their MBA-honed negotiation skills, are taking it a step further by telling the lawyers to get lost, bringing them in only at the last minute to translate into legalese what they've already agreed to in normal speak. "We settled our divorce in about 10 minutes at dinner at Vico," says Gary S. Goldstein, who runs New York-based headhunting firm the Whitney Group with his ex-wife, Alicia C. Lazaro. Adds Lazaro: "I had a great divorce. No question about it."

PLAYBOOK: BEST-PRACTICE IDEAS

The Ex Files

More exes are staying in business or careers together. Some of the more constructive tactics:

APOLOGIZE To one another, co-workers, and employees. Assure all parties that it won't affect work quality and productivity.

COMPARTMENTALIZE At the office, never discuss divorce. Refrain from disparaging one another among associates.

COMPROMISE Negotiate your own settlement together. See what you can give, rather than what you can get. Then let the lawyers be scribes.

PUBLICIZE Let clients hear the news from you. Answer concerns. Provide extra attention and a reassuring front.

Data: BusinessWeek, Divorcemagazine.com

Like many of the good-divorce set, the couple split their assets down the middle, kept their premarital belongings to themselves, and worked out a mutually amicable custody arrangement for their two daughters. Good-divorce couples often also share holidays together. For Thanksgiving, Alicia is joining Gary, their two college-age kids, Gary's current wife, and their eight-year-old son, who calls Alicia "Auntie," on a trip to Marrakesh.

Many with amicable divorces divide their assets down the middle

That's not to say the non-acrimonious route works for everyone. To succeed "it means both people have to want it to be handled that way," says Joy Feinberg, a partner at Chicago family law firm Feinberg & Barry. The biggest challenge for couples who want to continue as partners at work, says Feinberg, is overcoming extra-marital affairs. Paul Keevil, owner of Richmond (Va.) landmark eatery, Millie's, says he was utterly crushed when he discovered that his wife was seeing someone else. "At first I thought: 'I can't do this, it's too painful,'" says Keevil. Six years later, they are still working together and sharing profits. Says Paul's ex, Lisa Edwards Keevil: "A lot of people on the outside are dumbfounded, but to us it seems natural because we are such a good fit in terms of our skills and strengths."

In talking to family lawyers about what kind of couple-colleagues succeed at the new divorce, the Honigs emerge as exemplars. They continue to share the office they had when they were married, which is separated by a sliding glass door. They both live on the 68-acre ranch property (albeit in separate houses), travel to wine shows together, and, when they are in separate cities, talk on the phone an average of four times a day. When Elaine turned 40 last year, Michael threw the party. Elaine brought a date. "Michael and I have always problem-solved really, really well," says Elaine.

Granted, the transition from Mr. and Mrs. to friend and co-worker was traumatic. When they returned from their Four Seasons weekend three years ago with news of their split, they had to face the shock of their 25 employees. To help ease workers' and clients' anxiety, the Honigs lavished praise on one another during meetings. When they did discuss their hurt feelings, they stuck religiously to the marital-counseling script of "when you do _____, I feel _____." Both also erred on the side of generosity and forgiveness rather than suspicion and greed.

A big challenge has been convincing the people they date that their relationship is strictly business. "One guy couldn't believe I wouldn't say anything negative about Michael," says Elaine. Another of her difficulties: Now that she is no longer his wife, would Michael value her? Respect her? "But Michael is always very loyal and incredibly reassuring," says Elaine. "He always tells me: 'You are my co-pilot. And I can't run this business without you.'" ■

–By Michelle Conlin in New York

Three Generations, One Roof

More and more households are doubling up. Here's how to make it work. **BY ANNE TERGESEN**

STACEY EGAN WAS nine months pregnant with her third child when she called off her family's search for a home in Rye, N.Y., a New York City suburb where the median-priced home now sells for over $1.3 million. The Egans had outgrown the two-bedroom condo they had purchased in Rye in 2000. But they were tired of watching $850,000 fixer-uppers get snapped up before they even had a chance to bid. "Anytime an affordable house would come on the market, it would sell in a day," she says. ¶ So about a year ago, Egan and her husband, Michael, a compliance officer for a Wall Street firm, did what a growing number of families are doing: They moved back in with (her) mom and dad, whose five-bedroom empty nest in Rye has plenty of room for a growing family. ¶ Yes, the extended family is making a comeback. In many cases, generations are squeezing under one roof, sometimes by refurbishing basements or building extensions for the in-laws or grandkids. They're also living in family compounds that feature garage apartments or guest cottages. In response to surveys of home buyers, builders are offering second master bedrooms and "accessory" units, such as so-called granny flats, and guest homes in a growing number of mainly upscale housing developments. And Dallas-based CTX Mortgage offers a mortgage for multifamily households in Florida that considers the senior generation's income when qualifying—without requiring them to be listed on the loan.

According to the latest U.S. Census data, the number of households with three or more generations living under one roof grew 38% from 1990 to 2000, vs. 8% for those with just two generations. Doubling up is most common in states where home values have soared as well as in places with large populations of immigrants from countries accustomed to multigenerational living. Extended households now account for 5.6% of California's total, vs. almost 4% nationally. And 8.2% of Hawaii's households are multigenerational. With the affordability of starter homes at a 15-year low, the pressure to double up is likely to remain.

BETTER LIFE

THOSE LIVING IN three-generation households say the arrangement can solve a host of financial and practical problems. Most obviously, money saved on rent can fund a downpayment on a separate home later. It can also allow breadwinners to stay home with kids or start businesses. Some say they enjoy a better quality of life, with shorter commutes and access to better schools. One extended clan discovered that for the price of two three-bedroom homes on quarter-acre lots in Atherton, Calif., they could jointly finance something far more grand—a five-bedroom place on an acre with a pool and a 1,200-square-foot guest house for the grandparents. "In our case,

To Minimize Conflict

DIVIDE THE DECISION-MAKING Grandparents should defer to parents when it comes to making rules for the kids. Homeowners should have the final say over how the house is organized.

BE FLEXIBLE "You have to work around one another," says Fran Gery, who sometimes bakes the cookies she sells to local shops in the evenings so her daughter can have the kitchen during the day.

COMMUNICATE Some families have regular meetings. Others sit down when problems arise. When arguments occur, take time to cool off.

THINK CREATIVELY If mom's always cold and grandpa's always hot, install separate thermostats.

DON'T FIGHT EVERY BATTLE If someone leaves dishes on the table or forgets to take out the garbage, you might be better off just letting it go.

TENDED FAMILY
ne and Peter Clark
enter in back) with
ristie, Caroline,
zabeth, and Jane's
rents, Richard and
n Dorst

one plus one equaled three," says Peter Clark, chief financial officer at a Silicon Valley technology firm whose family lives with his in-laws, Richard and Ann Dorst.

Families also say that by living together, they're better able to meet evolving needs, from child care to eldercare. Clark says his in-laws at times have been "like second parents" to his three daughters. But "when they get older, we'll be there if they need anything."

Such arrangements have lots of challenges, however. As with marriage, the division of household bills and chores can be sources of conflict. There are privacy issues. Families who live together permanently may also need to work out an estate plan—without stepping on other heirs' toes. When children are involved, parents and grandparents may have to resolve differences over child rearing.

Moving back to the nest can be hard on the ego, too. "The stereotype is that adults who live with their parents are losers," says Jeffrey Mordan, a private-school art teacher whose family moved into his wife's childhood home in Hill Town, Pa., two years ago, in part to finance the master's degree in teaching he'll earn in 2007. Sometimes, too, it's easy to lapse into past patterns, with parents dictating rules and adult children reverting to childlike roles.

If you're thinking about giving mom and dad the guest room or suspect you may soon be sharing close quarters with a boomerang child, here are tips from families living in extended households.

» Make a Plan

LONG BEFORE PURCHASING a family compound or calling a moving van, hash out a written plan for dividing the finances, chores, and space, advises John Graham, professor of international business at the University of California at Irvine's Paul Merage School of Business, who is writing a book with his sister, Sharon Niederhaus, about extended family living. Other topics might include house guests and parties.

If you'd prefer a temporary arrangement, agree on a timetable. Grandparents should be clear about how much child care they're willing to do. Parents should ask the household's other adults to respect their approach to child rearing.

» Privacy

FAMILIES SAY AN extended arrangement works best when each branch can retreat to its own space. Separate units are ideal.

But in many locales, zoning laws or deed restrictions prohibit guest homes and granny flats, says Andy Gianino, president of The Home Store, a Whately (Mass.) builder of custom modular units. Additions may also trigger an increase in property taxes or insurance premiums.

Families who share single-family residences can enhance privacy by occupying bedrooms on separate floors or opposite ends of the house. Mordan's in-laws, Fran and Terry Gery, converted a ground-floor multipurpose room into a master bedroom suite—a project that's been on their "to do" list for years. The Mordans and their two young children have the three bedrooms upstairs.

For families who live close by, knock before popping in. You can even reserve specific times for the immediate family to be alone. "Because of our busy schedules, dinner was the only time my husband and I could be with my daughter as a family. Fortunately, my mom did not feel she had to be part of our dinner," says Jill Ridky-Blackburn, whose mother, Lillian Ridky, now 90, moved into attached living quarters on the family's Chapel Hill (N.C.) property about 11 years ago.

» Finances

THERE ARE MANY approaches to dividing the bills. The Clarks and Dorsts evenly split fixed costs, such as property taxes and insurance. Why? Each owns about 50% of the property. But they allocate utility, phone, and cable bills on a per capita basis. In some cases, the generation with greater resources writes the checks. Parents might waive rent to help a child maximize savings and move out sooner. The key, according to Niederhaus, is for everyone to contribute, be it rent or yardwork.

Of course, even the closest families have arguments. To minimize conflict veterans suggest various strategies (table page 92). But there are great rewards, too. "We've gotten to know one another as families rarely do," says Fran Gery. "It's going to be hard to break apart." ■

Autos

STEPPING OUT Stylish, and it can burn rubber, too

A Rival for BMW?

The sporty GS Lexus 430 has what it takes to match the German carmaker—almost. **BY DAVID WELCH**

LEXUS CARS HAVE NEVER been known for their expressive looks or sporty driving. But starting about a year ago, with a pair of brash concept cars, Toyota Motor's luxury division swore it had plans to leave its snoozy styling behind. The strategy: to build cars that draw more attention on the road and give Lexus' customers all the adrenaline-inducing performance they want.

In other words, after giving Mercedes-Benz a thrashing over the past few years, Lexus wants to inject enough sport and passion into its cars to take on BMW. The first cars bearing the new look of Lexus are the GS 430 and GS 300 sedans. I tested the 430, which starts at $51,375 but goes up to $61,070 with options such as satellite radio, a navigation system, and a rearview camera that shows what's behind the car when driving in reverse.

The first test in the luxury sports-sedan class is speed. The car's 300 horsepower V-8 delivers. Lexus boasts that the 430 can make it from zero to 60 in less than six seconds. I punched the gas pedal on my neighborhood street, leaving a plume of dust as the acceleration sucked me into the leather seat. This car has enough giddyap to run with a Mercedes E-class, Infiniti M 45, Cadillac STS, or BMW 530.

But the real question is, does it handle like a Bimmer? The answer is no. Don't get me wrong: The GS is a pleasure to drive, with Lexus' new Vehicle Dynamics Integrated Management systems that instantly correct for tire slippage or spinning of wheels. It's a great feature for safety and improved handling. But unlike BMW, which allows the driver to switch off the traction-control system to push the car's limits, the Lexus runs the VDIM all the time. That makes it tough to see how much the car can handle when speeding through a sharp bend.

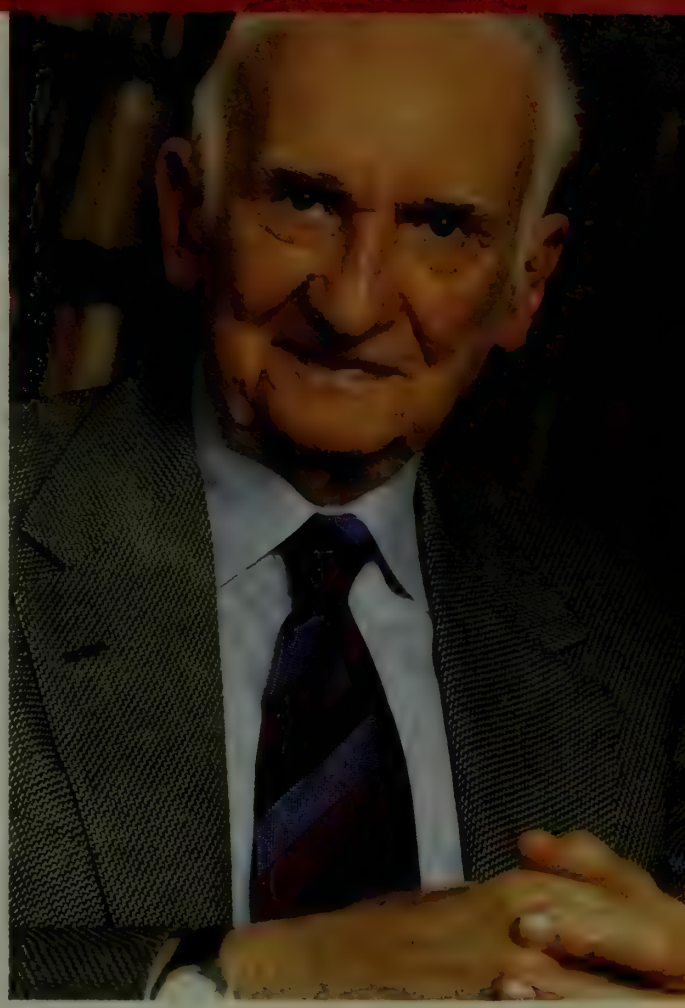
Styling is subjective, but give Lexus credit for stepping out. In the past its designers could be accused of knocking off Mercedes' looks. But the GS and the new IS 300/400 are really different. Lexus designers pushed the cabin rearward, so the car has a nice long hood. The roofline slopes down toward the trunk to improve aerodynamics and add a splash of style.

Inside, the GS is superb. Every knob and switch moves with precision accuracy. Lexus has hidden the controls for the mirrors, trunk, and fuel door in a fold-down panel to the left of the steering wheel. It's a nice touch, but the buttons are tough to reach when driving.

All in all, Lexus has come up with a great car. It's as refined as what we're used to but with more spirit than we've come to expect. ■

Why Most Meetings Stink

After attending 40,000 of them, 92-year-old business whiz Simon Ramo has a few tips



RESEARCH SCIENTIST AND BUSINESSMAN Simon Ramo has written several business and technical books, and even a couple on tennis, including *Tennis by Machiavelli*. His latest is *Meetings, Meetings and More Meetings: Getting Things Done When People Are Involved* (Bonus Books, $19.95.) Senior Correspondent Larry Armstrong recently called up the 92-year-old co-founder of what became TRW—the R is for Ramo—and asked for a meeting.

What are your credentials as an expert on meetings?

Two come to mind. The first is purely quantitative: I started going to meetings around age 20. So over 70 years I estimate that I've gone to more than 40,000. Not too many people have that much experience. Another one: I've spent time and effort observing the process, and that's not true of everyone who attends meetings. I'm not the only one who has noticed that meetings can be improved and that too many are unnecessary, but not everyone who notices these things does something about it.

Why are some companies better at running efficient meetings than others?

I have never known of the issue receiving the attention of top management. Those organizations that do a better job of meetings happen to be led by people who take an interest in wanting some productivity about the process. It's the individuals who stand out rather than the companies.

Do you have any tips for chairing meetings more efficiently?

The most important thing is to be prepared, to know the subject and purpose of the meeting, and what you hope it will achieve. If you can't find the time to prepare for meetings then you should stop calling so many. Another is to know the people who are invited. Think ahead as to which individuals are most likely to make the greatest contribution, and anticipate others who you'll have to, as tactfully and gently as possible, interrupt to move the discussion along. Finally, keep the objective of the meeting constantly in your mind so you'll keep moving toward the goal. But if the goal changes during or because of the meeting, be prepared to invent Plan B.

Over the years, has technology changed meetings?

Yes. Some for the better, some for the worse. As an example, information technology has made it possible for a lot of details to be made available quickly to a large number of people, so attendees can be better informed about anything being discussed. That's a positive. The negative is that people now present too much detail. With charts being created mostly by computers, people don't stop with the main points; they can't resist the unnecessary elaboration.

> "When you wake up [from dozing off], don't say 'what?' Say 'why?'"

RAMO Resist unnecessary elaboration—stick to the main points

Has technology created more distractions in meetings?

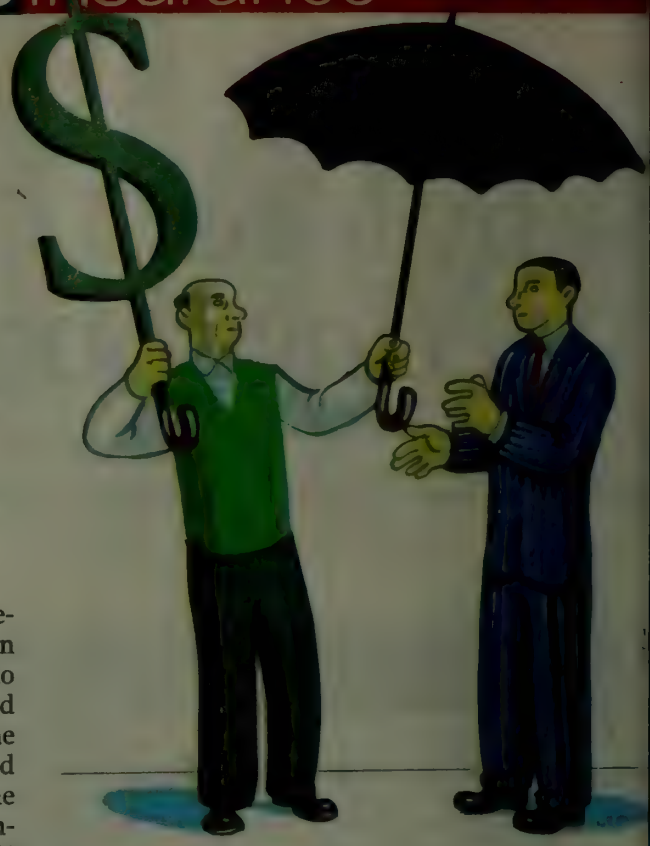
Technology has increased the potential for bringing new distractions, though I don't know that the total distraction level has changed. Are cell phones in meetings any more or less distracting than people being called out to take phone calls? Or people reading incoming e-mails instead of paying attention to the speaker?

I really liked the chapter on dozers and dozees, the people who doze off during meetings and the presenters who cause them to fall asleep. Any tips for dozers?

Almost everyone I know who has seen the book has felt compelled to comment about that chapter. If you attend enough meetings, it's inevitable that you'll doze off sometimes. Al Carnesale, the chancellor at UCLA, told me about the advice he got when he was younger: "When you wake up, don't say 'what?' Say 'why?'" ■

Wanted: Your Life Insurance

Investors are keen to offer "life settlements." Seller beware. **BY TODDI GUTNER**



REMEMBER THE HARD sell you got when you bought that insurance policy 20 years ago? Well, times have changed. It's quite possible the agent who sold you that policy now represents investors who want to buy it. They'll pay you a lot more than you could get from surrendering it to the insurance company, though the sum will be much less than the death benefit.

These transactions, called life settlements, may appeal to you if your life insurance needs have changed and you don't need the policy anymore. Or perhaps you don't think it's worth the escalating premiums, the result of low interest rates. But before you grab the money from an eager buyer, get some good advice from a financial planner, an estate attorney, or even your doctor.

Here's how the life settlements business works. Some firms like Coventry First LLC are bankrolled by hedge funds, pension funds, and in some cases large insurers like AIG. The settlement firms buy the policies from individuals on behalf of investors. The settlement company then acts on behalf of the investors, who become the owners and beneficiaries, and pays the premium until the insured dies. The firm collects the death benefit and pays its investors anywhere from 9% to 12% annual return. Other firms buy and repackage the policies for sale to a third party.

WAIT TO SELL

THESE DEALS PROBABLY sound a little familiar. They're similar to viatical programs of the 1990s where the terminally ill, many of them AIDS patients, sold their policies to investors to pay medical bills. Life settlement companies, however, target a different market—people at least 65 years old with some health conditions and life expectancies of 2 to 12 years. To qualify for a buyout, their policies must have death benefits of $250,000 or more.

Should you sell your policy? We asked fee-only life insurance advisor Peter Katt, principal of Katt & Co. in Mattawan, Mich., to analyze the numbers for a 7 year-old client who is considering selli his $1 million universal life policy. The li settlement company would p $275,000, vs. the $100,000 surrender va ue that the insurance company wou give. Sounds good—but not as good holding on without paying the premium Katt says you can use up nearly all t cash value to keep the policy in force and then sell it for an estimated $475,0 about five years out. Why so much mor The insured life expectancy is five yea less, and that means the policy purchas can get paid off sooner. "The longer y wait to sell, the more money the life se tlement firm will offer," says Katt, wi analyzes these offers for about $1,500.

Selling life insurance policies has e tremely high transaction costs. Accor

Cash Up Front

Sometimes you no longer want or need a life insurance policy. "Life settlement" companies typically offer to buy seniors' cash value policies as long as the death benefit is at least $250,000.

THE INSURED Bob, 72, a retiree

HEALTH He has had heart bypass surgery and a stent procedure

LIFE EXPECTANCY Eight years

POLICY $1 million universal life, bought in 1985

COST BASIS $280,000

ANNUAL PREMIUM Set at $14,000 initially, but now up to $37,000

CASH VALUE $100,000

WHAT CAN BOB DO?

- Cash in policy with the insurance company for $100,000.
- Sell policy to a life settlement firm for an estimated $275,000
- Reduce the death benefits to $375,000, which will allow him to keep the policy in force for 12 years without having to make additional premiums.
- Stop paying premiums but don't reduce the death benefit. That will run the cash value down to near zero in about five years At that point, if Bob's health is about the same, a life settlement firm should be willing to pay $475,000 for the policy because his life expectancy is now about three years. If he dies in the interim Bob's beneficiaries will still get $1 million.

Data: Katt

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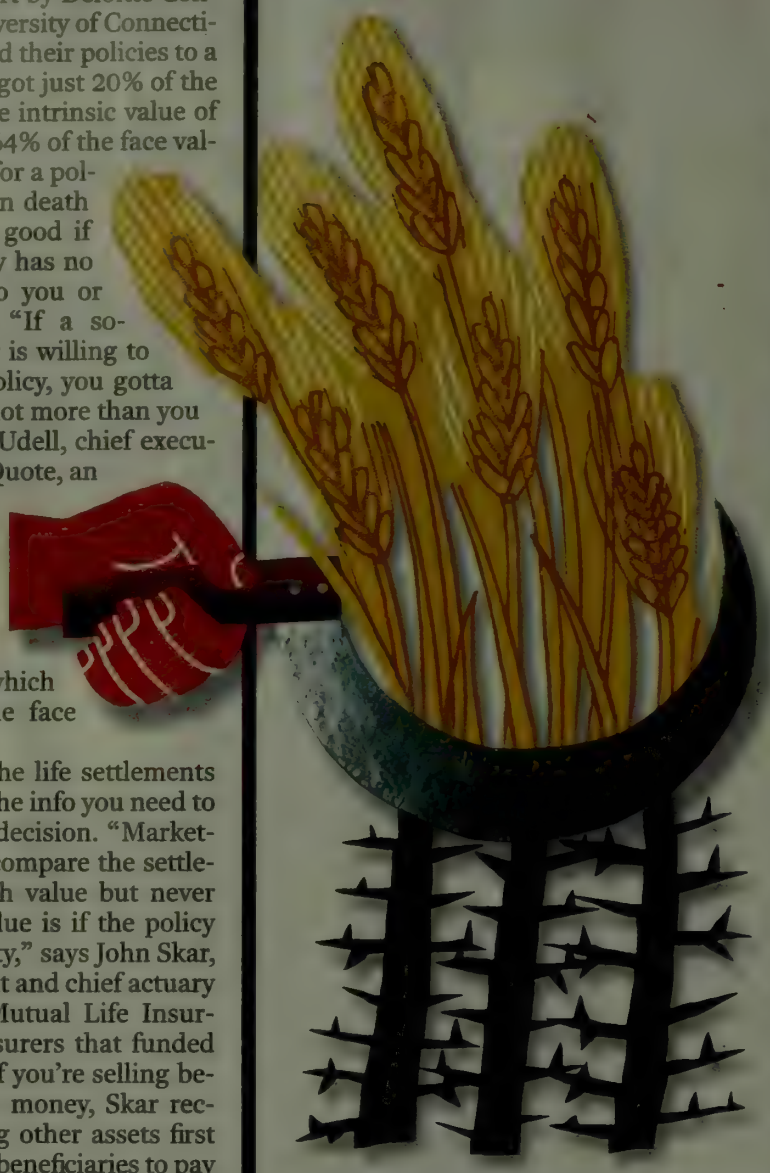
ing to a recent report by Deloitte Consulting and the University of Connecticut, seniors who sold their policies to a life settlement firm got just 20% of the face value, while the intrinsic value of the policy is about 64% of the face value. Still, $200,000 for a policy with a $1 million death benefit may sound good if you think the policy has no value other than to you or your beneficiaries. "If a sophisticated investor is willing to pay you for your policy, you gotta believe it's worth a lot more than you know," says Byron Udell, chief executive officer of AccuQuote, an online insurance broker. The high fees, says Alan Brueger, CEO of Coventry First, help to cover the future premiums which average 60% of the face value of the policy.

Don't count on the life settlements firm to give you all the info you need to make an informed decision. "Marketing materials only compare the settlement offer and cash value but never what the estate value is if the policy were held to maturity," says John Skar, senior vice-president and chief actuary of Massachusetts Mutual Life Insurance, one of the insurers that funded the Deloitte study. If you're selling because you need the money, Skar recommends unloading other assets first or even asking your beneficiaries to pay the premiums.

Before you sell, you want to be reasonably sure that you won't need another life insurance policy. If you get remarried or go into a new business, life insurance may be necessary. Your old policy will be active and that may limit your ability to buy more insurance.

Then there are tax issues. Death benefits go to your beneficiaries tax-free, which is one of the attractions of life insurance. Selling the policy will result in a tax bill if the settlement amount exceeds your cost basis.

If you choose to sell your policy, shop for the best price. Udell tries to get four bids. On a $1 million policy, he received offers from $175,000 to $250,000. What accounts for wide variation is different actuarial assumptions and the commissions the settlement companies pay their agents. In short, be as skeptical when you sell your life insurance policy as when you buy it. ■



A Rich Harvest of Losses

How to get the max in tax benefits. **BY LEWIS BRAHA**

NOW'S THE TIME O year when farme harvest their crops and investors harve their losses. Th means checking yo portfolio to see if the is anything you can sell to offset gains reduce 2005 taxable income (table).

The basic strategy is to find losses ar squeeze some tax benefit from ther Short-term losses are more valuab than long-term losses. Why? They can l used to offset short-term gains on whi the tax rate can run as high as 35%, d pending on your income. If your shor term losses exceed short-term gains, yo can deduct up to $3,000 of losses fro

TAX PLANNING

Time for A Yearend Checkup

If you want to fund a new wing at your alma mater or start a foundation to benefit hurricane victims, now's the time to do it. According to the Katrina Emergency Tax Relief Act of 2005, donors to any charity in 2005 are allowed to deduct the entire contribution come tax time instead of the usual maximum of 50% of adjusted gross income. What's more, contributions exceeding your income can b carried forward for five years.

This is but one new feature of the tax code worth taking advantage of before 200 ends. Other perks are extensions or hikes o existing benefits and deductions. For instance, like last year, taxpayers may opt t deduct their state sales tax instead of their income tax, a perk for residents of the nine states without income taxes and for shoppers in general. "This is the last year sales taxes will be deductible," says Bob Scharin, editor of the journal *Practical Tax Strategies*. "If you're planning on making a substantial purchase—a car, jewelry, appliances—do it before the year ends."

If you have a large amount of appreciate stock, it might be good to start "gifting" it t your children or grandchildren, says tax analyst Mark Luscombe of CCH Tax &

dinary income. Anything more you can se in future years.

As you review your portfolio, there will e some stocks you're reluctant to sell. ell, for instance, is down 21.3% so far is year, but you still may think it's at-active. That's when the tax harvesting ets tricky. You can sell Dell for the loss nd buy it back 31 days later. But pur-ase any shares sooner, and you'll trig-er the "wash-sale rule," which will nul-y your tax deduction.

You can realize your losses toward arend without totally giving up your fa-ored stocks. One way is to double up—urchase Dell shares equivalent to the umber you want to unload—and sell the der, higher priced shares after 31 days. ou take a loss on the older shares, but es-blish a new position at a lower price. his is what portfolio manager Don Pe-rs of the T. Rowe Price Tax-Efficient rowth Fund is considering with Wal-art Stores and Avon Products. "I don't pect them to do much in the short-rm," he says. "But they are so attrac-vely valued that long-term investors ould consider doubling up or doing mething to maintain their exposure."

UY A COMPETITOR

NOTHER TACTIC IS to swap your losers r similar securities. You could sell Wal-art and buy a mutual fund or exchange-aded fund that is heavily invested in al-Mart such as the Rydex Retailing und, which has a 6.9% Wal-Mart posi-on or Retail HOLDRs, which has 17.5%. he risk is the fund may not move dollar r dollar with Wal-Mart.

Or you could buy a competitor's stock. "Target probably is the best substitute for Wal-Mart," says T. Rowe's Peters. But Target's customers come from a higher-income group, so the stocks might not track exactly. Peters suggests replacing Wal-Mart with a combination of Target and Dollar General Stores, which serves a lower-income customer.

You can also harvest losses, double up, or swap losing mutual funds. Just be careful not to buy a new fund right before it's about to make a capital-gains distribution at yearend. (Call the fund company or check the Web site for the distribution date.) In fact, swapping funds is easier than stocks because while no two stocks are exactly alike, fund portfolios often overlap. Although, for instance, you cannot replace one Standard & Poor's 500-stock index fund for another without violating the wash-sale rule, you could sell your S&P 500 fund and buy an iShares Russell 1000 exchange-traded fund, which has more than half of its portfolio invested in the same stocks.

Perhaps the best tax-harvesting opportunities are in bonds. Because the same companies offer multiple issues, you can essentially swap one bond from a company for another with a different maturity and coupon payout, says money manager Ivan Gefen, who oversees $250 million in taxable accounts at vFinance. "When the credit ratings of GM and Ford bonds got downgraded this year, they took a nosedive," he says. "Those companies have hundreds of issues you can swap."

While it's good to harvest tax losses now, many pros do it whenever the opportunity arises. "The tax clock is ticking very loudly this time of year," says Duncan Richardson, manager of the $18 billion Eaton Vance Tax-Managed Growth Fund. That's why the market often falls in October and November, and bargains abound. Put it on your to-do list for 2006: Harvest your losses early and often. ■

Hunting for Tax Losses

Looking for stocks to sell for tax losses? Do you own any of these? They are this year's losers among the 25 largest stocks in the Standard & Poor's 500-stock index.

STOCK/ SYMBOL	PRICE*	2005 RETURN*
Verizon Comms. VZ	$29.40	-24.04%
Dell DELL	32.49	-21.33
IBM IBM	82.59	-15.64
Wal-Mart Stores WMT	45.24	-13.56
Cisco Systems CSCO	17.17	-11.13
JPMorgan Chase JPM	34.00	-9.42
Home Depot HD	38.46	-9.34
SBC Comm. SBC	22.20	-9.12
Pfizer PFE	24.12	-8.34
Bank of America BAC	42.05	-7.71
Microsoft MSFT	24.53	-7.35
Time Warner TWX	18.10	-6.67
General Electric GE	34.01	-5.03
Citigroup C	44.81	-4.32
Amer. Intl. Grp. AIG	63.10	-3.27
Wells Fargo WFC	59.14	-2.51

*As of Oct. 17, 2005

Data: Morningstar

Accounting. Long-term capital-gains tax rates are currently only 5% for people with incomes lower than $29,700 this year—most children fall into this category—compared with 15% for those with higher incomes. You can give up to $11,000 a year to a recipient without having to pay the gift tax. And you can exceed that limit as long as you don't give more than $1 million in your lifetime. But children under age 14 cannot receive more than $14,000 a year without being subject to the "kiddie tax"—they're taxed at the donor's rate after that level.

Of course, not everything in the tax code this year is a gift. Millions of Americans will suffer again from the alternative minimum tax (AMT), which disallows deductions for people in high income brackets—and sometimes for those in the middle, too. In fact, an AMT exemption, created in 2001, expires at the end of this year. Unless

Congress votes to extend it, the ranks of AMT sufferers will explode. "About 3 million people will be subject this year," says tax expert Martin Nissenbaum of Ernst & Young. "Next year there'll be 12 million to 13 million unless something is done." Because of that risk, Nissenbaum recommends that taxpayers not subject to the AMT this year accelerate their deductions, such as paying January real estate taxes in December, to avoid taking a hit next year.

When doing your tax checkup, also consider the following:

—Higher-education deduction: Individuals may take a $4,000 deduction to pay for college expenses if their income does not exceed $65,000 ($130,000 for married couples). Those with incomes lower than $80,000 ($160,000 for married couples) may take a $2,000 deduction.

—IRA contributions: You have until Apr. 15, 2006, to contribute up to $4,000 ($4,500 if you're 50 or older) for 2005.

—Medical expenses: These must exceed 7.5% of your adjusted gross income to be deductible. If you're near that threshold, you may want to have elective surgery or dental work done now and pay for it before yearend. *–Lewis Braham*

INVESTING

Beware of Seers

WALL STREET'S INVESTMENT experts all seem to come from Lake Wobegon, the fictional burg created by humorist Garrison Keillor where "all the children are above average." A recent study published in the *Journal of Behavioral Finance* found that two-thirds of analysts said they were above average at forecasting earnings.

Such thinking can be hazardous to your wealth, says James Montier, global equity strategist at **Dresdner Kleinwort Wasserstein.** In a new report called "The Folly of Forecasting," Montier cites a **Federal Reserve Bank of Philadelphia** study showing that interest rates fell 55% of the time when bond prognosticators predicted they would rise. The track record of equity analysts isn't much better.

What's an investor to do? Use strategies that don't rely on forecasting. One such method is value investing, buying cheap stocks with low price-earnings ratios, low price-to-book ratios, or above average dividend yields. Another is asset allocation, where long-term performance depends on how you divide your portfolio among stocks, bonds, and other assets—not trying to pick hot stocks. *—Christopher Farrell*

TIME OFF

MOST VISITORS TO Rockefeller Center in New York are on the ground, looking up. Now you can be on top of the Art Deco landmark, looking down. Beginning on Nov. 1, you can buy tickets for the observation deck at 30 Rockefeller Plaza by going to topoftherocknyc.com or calling 877 692-7625. The site—now with viewing galleries on the 67th, 69th, and 70th floors—has been closed to the public for 20 years. It offers visibility of up to 80 miles.

—Monica Gagnier

EDITED BY TODDI GUTNER

AUCTIONS

A TROVE OF JFK MEMORABILIA

CAMELOT IS COMING back to the auction block. From Dec. 15 through Dec. 17, Guernsey's will sell some 1,500 lots relating to John F. Kennedy's life both a **New York's Park Avenue Armory** and on **eBay Liveauctions.** (Ebayliveauctions.com will offer nearly 500 more JFK items exclusively.) Culled mostly from the estate of Robert White, who started corresponding with the President at age 15, items include the two flags that were mounted on JFK's limo when he was assassinated, an oil study for his official portrait by artist Aaron Shikler, the watch from his inauguration, and a passport. White, who died in 2003, got many papers from JFK's secretary, Evelyn Lincoln. Catalogs for $50 will be available on Nov. 10 at guernseys.com. *—Lauren Young*

TAXES

DEFERRED COMP BREATHE EASIER

GOOD NEWS for execs with deferred-compensation plans. The **Internal Revenue Service** has delayed by one year—from Jan. 1, 2006 to Jan. 1, 2007—the effective date of tough rules, passed after the **Enron** debacle, on tapping the accounts. The new regs generally doubl the penalty to 20%—plus the threat of retroactive interest payments to the IRS—on money taken before a preset distribution date. They also require those who postpone distributions to give at least a year's notice—up from as little as three months—and to leave the money for five years after the original date. *—Anne Tergese*

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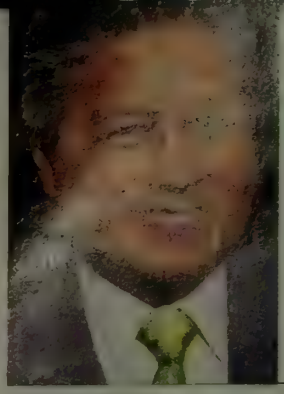


BY GENE G. MARCIAL

AVIAN FLU CONCERNS ARE SENDING BIOCRYST SKYWARD.

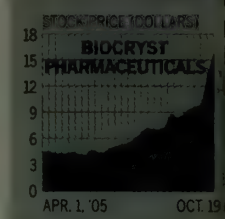
A FRENCH ENERGY GIANT IS SWEET ON SULPHCO'S TECHNOLOGY.

AFTER A NUMBERS GAFFE, BEARINGPOINT IS POISED TO REBOUND

Why Biocryst Has Wings

SHARES OF BIOCRYST PHARMACEUTICALS (BCRX) are on fire, soaring from 4.39 a share in early April to 15 on Oct. 19. The reason: bird flu. With the increasing global concern over avian influenza, "Biocryst is attracting investor attention because of its antiviral drug, Peramivir, which some scientists see as a promising treatment for avian flu," says John McCamant, editor of the *Medical Technology Stock Letter*. Roche's Tamiflu is the leading anti-flu drug on the market, and because of a World Health Organization warning on the possibility of a flu pandemic caused by the H5N1 virus, some countries have started stockpiling Tamiflu. GlaxoSmithKline's Relenza is the other approved flu drug. Despite Biocryst's fast runup, it has more room to climb, partly because its market cap of $480 million doesn't fully reflect its other products. Among these are Fodosine, its chief drug aimed at T-cell leukemia, and BCX-4678 for hepatitis C, says McCamant. Vinny Jindal of Wedbush Morgan Securities believes Peramivir could well compete with Tamiflu as it has several advantages, including lower cost per dose and Biocryst's ability to ramp up production. He says under the Project BioShield Act on biodefense, the U.S. can stockpile Peramivir after filing efficacy studies on animals and a safety study on humans—which, he adds, Biocryst could complete by early 2006. It is also starting a Phase 3 trial on Peramivir in Southeast Asia sponsored by the U.S. National Institutes of Health. Jindal, whe rates Biocryst a buy, says the results will help hasten Peramivir' approval as a new drug. If all goes well, he expects the compan will see Peramivir sales of $450 million in 2006. With its other products, Biocryst's worth could be 35 a share, says Jindar.

A TOUCH OF FLU



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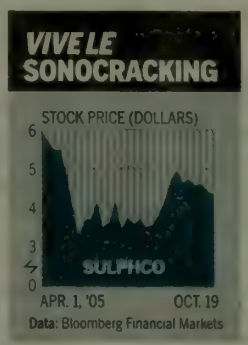
otal Trust in SulphCo

ULPHCO IS NO TITAN in the oil patch, but its Sonocracking technology may put it on the map. It upgrades crude oil by reducing sulfur and nitrogen through the use of high-power rasound. That squeezes an extra seven or gallons of fuel from every barrel, says lphCo President Peter Gunnerman. Oct. 11, French energy giant Total inked act with SulphCo—which trades on e American Stock Exchange with the mbol SUF—to test Sonocracking on stream and downstream operations. tal got an exclusive on the technology Belgium, France, Italy, and Spain. In e U.S. and Mideast, SulphCo will rtner with other major companies, ys Gunnerman. It was in talks with evron, which has tested Sonocracking, for a licensing pact, t "we failed to come to terms," he says. Total's entry is a big al for SulphCo, says Ari Goldman of Endurance Capital, ich owns shares. Its "revolutionary" technology could help t U.S. imports, he says. SulphCo, now at 4.33, should bolt gher once Total turns in positive test results, he predicts.



earingPoint of Recovery?

ONSULTING FIRM BEARINGPOINT (BE) helps companies set up internal systems to monitor financial results, among other things. So it was quite an barrassment when a $93 million accounting error was discovered there in 2004, causing a delay in the release of 2004 financial results due in mid-October. That, plus a related Securities & Exchange Commission inquiry, took its stock to 5.28 on Apr. 21 from 8.20 a week before. It has since risen to 7 as some pros bought in. One is Spencer Fleischer of investment outfit Friedman Fleischer & Lowe, which acquired some 6 million shares at 6.75 each. Despite its woes, BearingPoint's long-term growth rate is intact, says Fleischer, as it is "strongly positioned in the fast-growing business services market." Adam Frisch of UBS (it has done banking for BearingPoint and owns shares) says the smart money is focusing on the company's operating leverage, cost-cutting, and cash-flow growth, which should be evident in 2006 and 2007. Frisch says "BE is the most attractive investment opportunity in our coverage" based on its "untapped" earnings power. He sees it hitting 12 in a year. The answers that the SEC wants will be provided, he says, when the company posts its delayed results. He sees a loss of 2¢ a share in 2005 (due in part to restructuring and the cost of the PricewaterhouseCoopers audit on the accounting error), on sales of $3.7 billion. But Frisch forecasts profits of 43¢ in 2006 on sales of $3.8 billion.

BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

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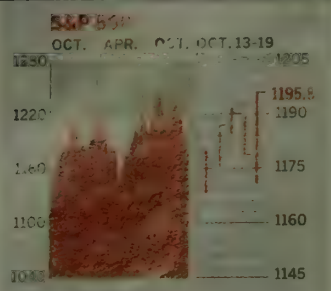
Personal Business Figures of the Week

STOCKS



COMMENTARY

After bouncing around, stocks ended the week on an upbeat note, thanks to a raft of positive earnings reports from such big caps as Motorola, IBM, and JPMorgan. Fed data suggesting the economy has weathered the worst of Hurricanes Katrina and Rita, along with a resilient housing market, lifted spirits, too. A word of caution: trading volume was light, especially on the NASDAQ.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	OCT. 19	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1195.8	1.5	-1.1	8.4
Dow Jones Industrials	10,414.1	1.9	-3.4	5.2
NASDAQ Composite	2091.2	2.6	-3.9	8.9
S&P MidCap 400	685.2	1.5	3.3	17.4
S&P SmallCap 600	335.3	2.5	2.0	16.6
DJ Wilshire 5000	11,907.7	1.6	-0.4	10.3
SECTORS				
BusinessWeek 50*	720.7	0.9	2.3	12.8
BW Info Tech 100**	358.0	1.0	-4.1	6.7
S&P/BARRA Growth	576.4	1.8	-1.0	7.7
S&P/BARRA Value	615.1	1.3	-1.7	9.1
S&P Energy	360.9	-2.7	25.0	31.5
S&P Financials	396.3	3.1	-3.6	6.4
S&P REIT	145.3	3.0	0.6	10.1
S&P Transportation	223.8	2.2	-7.3	4.4
S&P Utilities	156.1	-1.4	10.2	21.6
GSTI Internet	179.7	4.3	0.8	17.7
PSE Technology	794.3	2.5	2.0	15.8

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	OCT. 19	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST MO*
S&P Euro Plus (U.S. Dollar)	1391.6	-3.1	-0.4	1
London (FT-SE 100)	5167.8	-3.3	7.3	1
Paris (CAC 40)	4375.1	-3.1	14.5	19
Frankfurt (DAX)	4846.0	-2.7	13.9	2
Tokyo (NIKKEI 225)	13,129.5	-2.5	14.3	18
Hong Kong (Hang Seng)	14,372.8	-1.4	1.0	
Toronto (S&P/TSX Composite)	10,425.8	-0.6	12.8	19
Mexico City (IPC)	15,112.0	0.1	17.0	3

FUNDAMENTALS	OCT. 18	WEEK AGO	YEAR
S&P 500 Dividend Yield	2.12%	2.10%	1.72
S&P 500 P/E Ratio (Trailing 12 mos.)	18.1	18.3	18.9
S&P 500 P/E Ratio (Next 12 mos.)*	13.9	14.0	15.6
First Call Earnings Surprise*	2.74%	10.81%	2.17

*First Call C

TECHNICAL INDICATORS	OCT. 18	WEEK AGO	READ
S&P 500 200-day average	1199.0	1199.8	Negati
Stocks above 200-day average	44.0%	47.0%	Neutr
Options: Put/call ratio	0.93	0.92	Positi
Insiders: Vickers NYSE Sell/buy ratio	3.77	4.12	Negati

BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Internet Retailers	13.9	Oil & Gas Refining	95.6
Internet Software	9.5	Managed Health Care	92.9
Airlines	9.1	Health-Care Distrbtrs.	61.9
Agricultural Products	8.3	Oil & Gas Exploration	55.3
Air Freight & Couriers	7.2	Fertilizers & Ag. Chems.	54.9

WORST-PERFORMING GROUPS	LAST MONTH %		LAST
Home Furnishings	-16.7	IT Consulting	-44
IT Consulting	-15.9	Photographic Products	-32
Leisure Products	-13.9	Home Furnishings	-30
Tires & Rubber	-13.7	Automobiles	-30
Educational Services	-13.2	Aluminum	-24

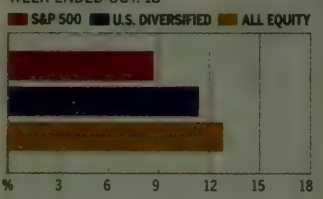
MUTUAL FUNDS

4-WEEK TOTAL RETURN

WEEK ENDED OCT. 18

52-WEEK TOTAL RETURN

WEEK ENDED OCT. 18



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Japan	0.0	Latin America	64.0
Diversified Pacific/Asia	-1.7	Natural Resources	37.4
Precious Metals	-1.9	Diversified Emerg. Mkts.	33.5
Miscellaneous	-2.0	Diversified Pacific/Asia	23.8
LAGGARDS		**LAGGARDS**	
Natural Resources	-9.5	Domestic Hybrid	7.0
Utilities	-7.1	Financial	7.5
Real Estate	-4.8	Large-cap Blend	8.8
Communications	-4.7	Miscellaneous	8.9

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
ProFds. USh. Sm. Cap Inv.	11.2	T. Rowe Price Lat. Am.	69.4
Potomac Sm. Cap/Sh. Inv.	11.0	iShares S&P L. Am. 40 Idx.	69.2
ProFds. USh. Mid Cap Inv.	8.8	iShares MSCI Brazil Idx.	68.9
ProFunds UltraBear Inv.	7.9	Fidelity Sel. Mdcl. Del.	67.1
LAGGARDS		**LAGGARDS**	
Ameritor Investment	-18.2	Ameritor Investment	-62.5
ProFunds Oil & Gas Inv.	-17.5	ProFds. USh. Mid Cap Inv.	-26.2
American Heritage Grth.	-16.7	ProFds. USh. Sm. Cap Inv.	-21.0
ProFunds Utilities Inv.	-12.3	American Heritage Grth.	-16.7

INTEREST RATES

KEY RATES	OCT. 19	WEEK AGO	YEAR A
Money Market Funds	3.31%	3.27%	1.29
90-Day Treasury Bills	3.85	3.70	1.82
2-Year Treasury Notes	4.24	4.23	2.55
10-Year Treasury Notes	4.46	4.44	4.03
30-Year Treasury Bonds	4.69	4.66	4.62
30-Year Fixed Mortgage†	6.06	5.96	5.71

†BanxQuote, Inc

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.88%	4.58
Taxable Equivalent	5.54	6.54
Insured Revenue Bonds	3.99	4.63
Taxable Equivalent	5.70	6.61

THE WEEK AHEAD

EXISTING HOME SALES *Tuesday, Oct. 25, 10 a.m. EDT* »Home sales probably slowed to an annual rate of 7.1 million in September, from a rate of 7.3 million in August. That's the median forecast of economists surveyed by Action Economics.

CONSUMER CONFIDENCE *Tuesday, Oct. 25, 10 a.m. EDT* »The Conference Board's October consumer-confidence index is expected to have edged down to 85.8, after tumbling almost 19 points, to 86.6, in the prior month.

DURABLE GOODS ORDERS *Thursday, Oct. 27, 8:30 a.m. EDT* »September orders for durable goods most likely held steady, after bouncing back with a 3.4% increase in August.

GROSS DOMESTIC PRODUCT *Friday, Oct 28, 8:30 a.m. EDT* »Real gross domestic product most likely grew at an annual rate of 3.4% in the third quarter, following second-quarter growth of 3.3%. Hurricanes Katrina and Rita are not expected to have had a huge impact on national economic growth during the third quarter.

EMPLOYMENT COST INDEX *Friday, Oct. 28, 8:30 a.m. EDT* »Compensation is forecast to have increased by 0.8% in the third quarter from the second. During the second quarter, wage and benefit costs grew 0.7%.

The *BusinessWeek* production inde increased to 257.6 for the wee ended Oct. 8, a 12.7% jump from th previous year. Before calculation the four-week moving average, th index rose to 257.5.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit **www.businessweek.com/magazine/extra.h**

The Companies

is index gives the starting page for a story or feature with a nificant reference to a company. Most subsidiaries are indexed under eir own names. Companies listed only in tables are not included.

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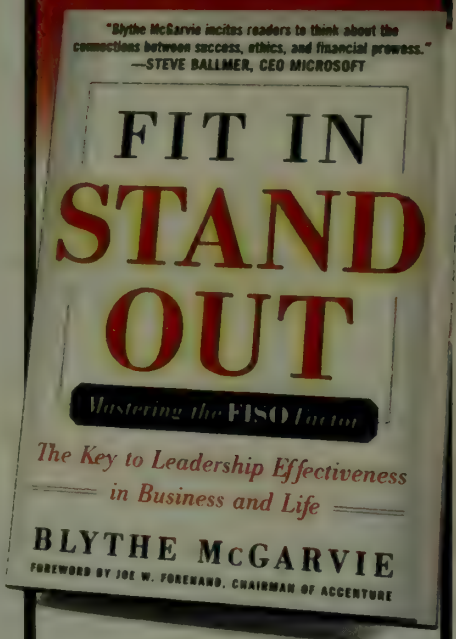

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STORAGE 2005

ILM Solving the Puzzle

INFORMATION LIFE CYCLE MANAGEMENT

Who could have guessed what a ghtmare the dream of a perless office would turn it to be? Not only is there ore paper than ever, but gital data has flooded the fice landscape. The scene in e 1973 movie "Sleeper," where oody Allen frantically tries to beat back advancing lava-like flow of pudding th a broom, is an apt metaphor for the allenge IT professionals face today.

Early in Paul Stonchus's 25-year IT reer, for example, the focus was on oving data progressively through tiered yers of increasingly remote but less pensive storage options – a practice nown as hierarchical storage anagement (HSM). Today, Stonchus, rst vice president and data center anager at MidAmerica Bank, relies on a rategy for organizing data known as ILM, information life cycle management. ILM more than just storage, he says. It's a key usiness initiative that reduces costs and creases the value of information assets the $9.4 billion Chicago-based bank. For at reason, managing corporate information assets with ILM has become a primary responsibility for business executives as well as IT leaders.

BETTER THAN A BROOM

"While the cost of storage for hardware has steadily declined," he says, "managing the infinite or ever-growing amounts of data that businesses generate without an ILM strategy would be extremely difficult. Being able to archive data intelligently has helped us to plateau our storage requirements, especially for imaging and e-mail systems. The paybacks are huge – not just from a dollars and cents perspective, but also from a manageability standpoint."

And yet, ILM is a loaded term for many storage vendors and users. An initiative that storage makers once promoted as "HSM on steroids" has now taken on a different meaning. "ILM is a robust information management practice," says Sheila Childs, chair of the Data Management Forum for the Storage Networking Industry Assn. (SNIA), in San Francisco. "It is designed to help companies better manage their information environment through archiving, security, and compliance."

When polled, most storage and business decision makers express disinterest in ILM. Yet when they reveal their current storage challenges, it turns out that a majority of respondents are involved in storage projects designed to achieve ILM's main goals: cost reduction and value enrichment.

Storage companies say that approximately 70% of their customers embrace archiving, compliance, and security tools and practices with the goal of containing storage costs that are skyrocketing. Experts estimate that the volume of stored data grows dramatically each year, with increases ranging up to

"ILM is a robust information management practice designed to help companies better manage their information environment through archiving, security, and compliance."

Sheila Childs, SNIA

75% just in 2005. Thanks to burgeoning government and industry regulations, this data must be retained for longer periods – seven years for certain financial data and up to 20 years for some medical records. Moreover, companies must be able to quickly find specific pieces of this information to meet regulations and litigation discovery demands.

The discovery process is slowed by the fact that only about 10% of all corporate data is stored in databases, where it can be retrieved relatively easily. The rest of the data is considered unstructured, which means that it is stored as content without any formal means of easily retrieving it.

THE BROADCAST JOKES DON'T HELP

E-mail messages are the best example of the kind of unstructured data that is difficult to find and retrieve. Thanks to e-mail's ubiquity, the volume of e-mail messages (which for regulatory reasons must often be saved) soars each year. As a result, e-mail is a significant contributor to rising storage and retrieval costs.

The City of Oceanside, Calif., recently began using content-archiving software from Symantec Corp., in Cupertino, Calif., to help meet requests for public records. The city of 165,000 residents receives between 9,000 and 12,000 e-mails each day. California legislation grants the public the right to request information, including e-mail messages and attachments, on any topic related to city business, including election filings and results. Says Oceanside CIO Michael Lee Sherwood: "We recoup the money we spent to purchase and maintain the system if we use it for just a few requests in a year. Since we process roughly 30 requests a year, and more in an election year, the ROI is tremendous."

The ability to carefully store and efficiently retrieve e-mail is also important because e-mail is often the first target of legal discovery and search processes. "In more and more legal cases, e-mail is the smoking gun," says Jeremy Burton, senior vice president for the data management group at Symantec. "The amount of money spent on litigation support – especially to disclose information – is huge."

But cost reduction is just ILM's most obvious benefit. Some storage customers have figured out they can use ILM to create new or additional value from the information assets they already have. Companies in health care, biosciences, oil and gas, and financial services are using existing data to identify customer trends, understand historical data, and discover new business opportunities.

BLUE-LIGHT SPECIAL

Fortunately, storage makers are hard at work developing new technologies and different approaches that are designed to meet these critical business needs. Plasmon Inc., in Englewood, Colo., has introduced archiving systems based on Ultra Density Optical (UDO) technology. This high-density technology uses blue lasers to record data on optical media. Like a fine-point pen, blue lasers can write more data in the same space than traditional red ones.

The new technology allows organizations to save data to rewritable and write-once media (good for data that must be kept forever unchanged) or to compliant write-once media that can be written and shredded once (good for data that you want to eliminate after the required retention period). Its cost is roughly one-fifth that of traditional optical storage.

"UDO provides companies with a secure, permanent, and cost-effective archival storage technology specifically designed to meet growing regulatory and compliance requirements," says Chris Harris, Plasmon's president.

Being able to retrieve the data promptly also requires that organizations have a methodology in place that will address current and future needs. According to Don Loughlin, director of BrightStor storage management at Computer Associates Inc., in Islandia, N.Y., this methodology should consider three steps. First, companies need to classify their hardware to know what they have. Second, companies must classify their applications by business value, rather than the technology on which they reside. Finally, companies must classify their business processes, determining the value of each to the enterprise and the cost that is acceptable to protect them.

"Storage optimization and compliance go beyond storage hardware," says Loughlin. "Our customers tell us they need to wring out the promised value from their investment, both in direct cost savings and in enhanced usability. Most of the optimization work will soon fall outside the

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"For most of these companies, deciding how to employ the components of ILM is an optimization exercise. What changes can they make to get the most from their data and storage technologies?"

Chuck Hollis, EMC Corp.

UPCOMING EVENTS

CO-PRODUCED BY SNIA AND COMPUTERWORLD
WWW.SNWUSA.COM

Storage Networking World
Apr. 3-6, 2006
Manchester Grand Hyatt
San Diego, Calif.

Storage Networking World
Oct. 30-Nov. 2, 2006
Orlando, Fla.

Storage Networking World
Apr. 16-19, 2007
Manchester Grand Hyatt
San Diego, Calif.

UPCOMING SNIA EVENTS

www.snia.org

Management Developers Conference
Dec. 5-8, 2005
Santa Clara, Calif.

SNIA Winter Symposium
Jan. 23-27, 2006
San Jose, Calif.

Enterprise Information World
Feb. 28-Mar. 2, 2006
The Meadowlands
East Rutherford, N.J.

traditional, tiered storage-management approaches to these new strategies."

GETTING THE MOST FROM THE TOOLS

Storage companies offer a variety of storage hardware, archiving software, and other technologies to support a company's ILM strategy. But technology isn't the whole story. Well executed, ILM can be a robust information management practice – one that allows companies to better manage their storage environment while enhancing security and compliance. To ensure that this practice is properly managed, organizations such as SNIA are working to re-educate the market to the need for ILM policies and processes, not just tools. Even storage vendors are quick to point out that maximizing ILM means adjusting business processes and methodologies. "Today's tools and technologies are easily able to support the enhanced value of information," says Chuck Hollis, vice president of strategic marketing for information and storage management vendor EMC Corp., in Hopkinton, Mass. "For most of these companies, deciding how to employ the components of ILM is an optimization exercise. What changes can they make to get the most from their data and storage technologies?"

Many customers are reaching out to storage company experts who can help refine business processes and methodologies. "The number of existing professionals with these skills is small," says Hollis. "Many organizations need to hire providers to help categorize th information, understand how it is use from end to end throughout the busines and use the tools to automatically app value to the information and process according to predefined rules. The key t success in these arrangements is t ensure that the service provider transfer the knowledge to the company's IT staff.

Looking forward, getting a grasp of ILI fundamentals could make the differenc between competitive success and bein run out of business by the high cost complying with regulations and handlin litigation requests. "It's not just e-mai after all," says Burton. "Many companie are starting to consider strategies relate to instant messages, PDF files, and eve conversations transmitted through voice over-IP. It's an exploding amount of dat that business and IT executives must b prepared to manage." Trying to beat it a back with a broom isn't a winnin strategy. ■

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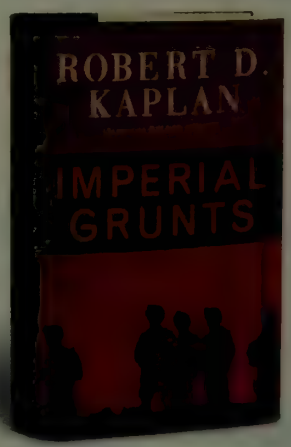
'Big Army Just Doesn't Get It'

IMPERIAL GRUNTS The American Military on the Ground
By Robert Kaplan; Random House; 421pp; $27.95

At the turn of the 21st century, Army Lieutenant Colonel Thomas Parker Wilhelm turned down a plum Pentagon posting for a job in the boondocks. The fluent Russian speaker had decided that he could make more of a difference as a military attaché in the Mongolian capital of Ulaanbaatar than on the Potomac—

and he was probably right. When Wilhelm arrived there in 2001, he found that the country was attempting to acquire an air force, even though it had neither a clear purpose for such a unit nor the expertise to maintain it. So, with the cooperation of the U.S. ambassador, Wilhelm persuaded the country's military to pursue a different course: secure Mongolia's borders not against a Chinese military invasion, which would be impossible, but against migration from that country and infiltration by Central Asian terrorists; improve its ability to respond to natural disasters; and train peacekeeping forces, which would raise the country's profile and provide diplomatic protection from Russia and China. Informally, Wilhelm was having more of a local-policy impact than any Pentagon bigwig.



Wilhelm is one of many thoughtful and effective U.S. military operatives profiled in Robert D. Kaplan's *Imperial Grunts: The American Military on the Ground*. The title notwithstanding, the *Atlantic Monthly* writer does not focus on mud-caked buck privates but on midlevel officers who rely more on wits than weapons. Their tales provide key lessons about how to address current threats across the globe—and even offer useful guidance for corporate managers. Despite one flaw—the author's misconceptions about imperialism—the book makes a valuable contribution to the debate over the military's future.

Fascinating insights abound. Robert B. Adolph Jr., a retired Special Forces lieutenant colonel, learned from experience, not books, that to spur development in Egypt, you give money to women, who want sewing machines to start businesses, rather than to men, who want TVs. In the Philippines, U.S. troops provided health care, reasoning that while treating children's skin diseases or fixing their teeth, American troops might glean important intelligence from their parents.

Kaplan offers such vignettes not only to show how savvy U.S. troops can be, but also to demonstrate that the best tactics often arise from the field, among folks well-acquainted with the culture and the turf, unguided by directions from D.C. It's a key lesson of what is often a brass-bashing book.

Afghanistan is Exhibit A for Kaplan's point. At first, Washington's only order was for U.S. forces to hook up with the Northern Alliance. Everything else got figured out by Special Forces in the field. So master sergeants could call in B-52 strikes, and operations were approved orally in minutes. The improvisation worked well. The discretion given to subordinates in the field "evinced the flat bureaucratic hierarchy which distinguished not only al-Qaeda but also the most innovative global corporations," Kaplan writes.

Two years later, a huge camp was in place in Bagram. Senior officers diluted operations in order to reduce risk and took days to approve missions. By the time U.S. troops were ready to attack, targets had vanished. Such bureaucratic methods might have been acceptable when the enemy was anticipated to be slow-moving Soviets in the Fulda Gap in Germany, but they're not right for today's threats. Listen to Lieutenant Colonel Marcus Custer: "Big Army just doesn't get it. It doesn't get the beards, the ball caps, the windows rolled down so that we can shake hands with the *hajis* and hand out Power Bars to the kids, as we do our patrols. Big Army has regulations against all of that." If you want to win the hearts and minds of a people, he adds, "you've got to love them, and love their culture." Self-serving? Sure. The truth? No question.

There is one flaw in Kaplan's work. He argues that the presence of some U.S. troops in scores of countries is evidence of a U.S. empire. Yet he notes that China and Russia, like the U.S., have defense attachés in Mongolia. If mere presence is empire, are three countries operating empires on the same turf? "Imperialism" has traditionally meant the exercise of sovereignty over another people, and at the very least it implies some measure of control. Yet despite U.S. forces in Saudi Arabia, Turkey, and Germany, all three nations hindered the U.S. drive toward war in Iraq. Some empire.

The best tactics often spring from midlevel people in the field—as they do in business

Still, Kaplan's conceptual lapse makes little difference. His account is an entertaining mix of shrewd military testimony and history. The message is more reassuring than you might think: While common sense often doesn't prevail at Pentagon headquarters, it frequently governs the strategies adopted by those deployed to outposts around the world. Headlines from Iraq and Afghanistan remain bleak. But Kaplan's dispatches from places that don't make the front page offer hope that some in the military are learning what they need to know. ■

–By Stan Crock

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IdeasViewpoint

BY LAURA D'ANDREA TYSON

A Stronger Yuan Helps China

In the past few years, China's trade and current account surpluses have surged. If recent trends persist, the current account surplus will roughly double, to around 7% of gross domestic product by yearend. Moreover, China will soon exceed the current account surplus of export behemoth Japan and is even on track to exceed Japan's foreign exchange reserves (long the world's largest) in the next few months. And while Japan stopped intervening in currency markets to influence the yen-dollar exchange rate in early 2004, China has continued to make big interventions to manage the yuan-dollar rate. So it's no wonder that China has displaced Japan as the focus of protectionist ire in the U.S., and Congress is threatening to impose a tariff of 27.5% on all U.S. imports from China unless it strengthens its currency.

Despite the howls from Congress, China's management of its exchange rate is not the reason America's current account deficit has soared in this period. As Morgan Stanley economist Stephen S. Roach recently observed, it would take the current account surpluses of 10 economies—including those of Japan, China, Russia, Germany, and Saudi Arabia—to equal the U.S. current account deficit. America is running a massive current account gap not because of an undervalued Chinese currency, but because the U.S. is saving too little to finance its investment needs. America's net national savings rate has been hovering at a record low of 1.5% of GDP since 2002—and it's likely to get worse over the next several months because of a Hurricane Katrina-induced surge of deficit spending. The result: The U.S. has been relying on the rest of the world for funds to offset its extraordinary savings shortfall. That's why, if the U.S. were to eliminate its current account deficit with China overnight, it still would be forced to run trade and current account deficits with someone else.

THERE ARE, HOWEVER, SOUND economic reasons for a revaluation of China's currency. Beijing took a first step in July by adopting an exchange-rate policy that ended its firm peg to the dollar. But the resulting yuan revaluation of little over 2% since then is insufficient. China's currency remains highly undervalued, as evidenced by the fact that Chinese authorities must continue to intervene in foreign exchange markets, adding to their vast holdings of dollar reserves that already cover more than a year's worth of imports and that amount to nearly 40% of China's GDP. There is no economic justification for China to invest so much in such low-yielding assets that risk substantial capital losses in the future. Indeed, China should both diversify its reserves away from dollars and draw down some reserves to finance strategic investments in local infrastructure, education, and research and development that will bolster future growth.

A sizable yuan revaluation also would curb China's dependence on exports for economic growth and encourage more investment in nontradable goods and services, such as food and electricity, which have suffered from persistent inflationary pressure as domestic supplies have failed to keep pace with rising Chinese incomes. And Beijing has the luxury of a large budget surplus that it can use to stimulate domestic demand to offset any temporary adverse effects on growth caused by a reallocation of resources from exports to nontradables. For example, consumption spending in China accounts for only 42% of GDP. By comparison, consumption spending claims a record 71% of GDP in the U.S.

> Beijing should use its reserves to update its infrastructure and fund education

China remains a poor country—one that should be running a current account deficit rather than a surplus. What size deficit can China sustain without running the risk of sudden outflows of capital, such as those that engulfed Asia in the late 1990s? No one knows for sure. But China should be able to finance an annual current account deficit at least equal to its annual inflow of foreign direct investment: about $50 billion, or nearly 4% of its GDP. That means there's room for a meaningful yuan revaluation (certainly in the 10% to 20% range) that could bring substantial benefits to China. It could also trigger revaluations of other Asian currencies that together would reduce the risk of a damaging trade war between China and the U.S. Indeed, Beijing should revalue the yuan not because of America's charges of currency manipulation and not because it will reduce the U.S. current account deficit. China should revalue because it would be good for the Chinese economy. ■

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Higher Ed's Higher Costs

WHO SAYS WE'RE living in an era of low inflation? The 2005 survey by the College Board confirms what parents of any student have known for years: Already stratospheric education bills are headed even higher. Tuition costs at four-year private colleges rose about 5.9% last year, to $21,235. Add in room and board, and the bill exceeds $29,000 annually. Meanwhile, even though tuition inflation actually slowed at four-year public universities, it still logged a 7.1% jump.

The result of this cost increase spiral: The net cost of attendance (after adjusting for grants and certain tax benefits for students) at a four-year private college now exceeds $19,000 a year. That's a lot to swallow, even for middle-class families. But for poor students, the bite is much, much bigger: It takes a staggering 83% of a poor family's annual income to fund the annual costs at a private four-year college—up from 60% a decade ago. To be sure, most of the poorest students receive financial aid. But increasingly, aid is shifting toward loans, so today's education sticker shock and the prospect of decades of college-debt repayment is causing many bright, poor students to seek cheaper two-year community college schooling—or simply to eschew higher education altogether.

Another College Board study on the impact of education o incomes shows that neither option is a great one. It found four-year college grads make roughly $20,000 more than their high school-trained counterparts. And people who earn two-year degrees make only about $7,000 more a year than high school grads. The bottom line: A four-year degree is becoming America's most-reliabl elevator of class and key to a middle-class standard of living.

A private college may cost a poor family 83% of its annual income

That's why Washington must d more to make sure college is a real option, financially, for more people A good place for Congress to start would be by finishing up reauthorization of the federal Higher Education Act, which would provide at least $420 billio in federal student loan guarantees over the next six years. Deliberations over competing House and Senate versions of the bill risk falling victim to lawmakers post-Katrina hunt to find funds to shrink the budget deficit. While we're certainly not against reforming student aid programs—the bill's move to save $6 billion to $10 billion by lowering certain ridiculously high lender incentives is long overdue, for instance—it's wrongheaded to consider big cuts i student aid at a time when it's needed more than ever.

Indeed, in an era in which Congress routinely wastes taxpayers' money on million-dollar missiles that repeatedly miss their targets and $315 million bridges to nowhere, America can surely afford to invest more in upgrading the skills of its most important resource: its workers.

The Invisible Lenders

IT'S NO SECRET THAT big banks have been beating a steady retreat from corporate lending, which had long been used as a loss-leader to gain lucrative investment banking or bond underwriting business from clients. That has left all but the best corporate borrowers, especially companies with lots of debt or shaky financials, scrambling for a steady source to provide working capital, expansion funding, or cash for acquisitions. Enter hedge funds, awash in cash and more than happy to serve a host of less-than-A-list borrowers like U-Haul International or Krispy Kreme Doughnut Corp. (page 34). Indeed, their share of the $506 billion leveraged loan market is now almost 50%, from less than 20% only five years ago.

There certainly are positives to having hedge funds and other private capital pools pick up the slack for such lending For instance, these new nonbank lenders have brought mor capital, faster decisions, and better loan terms to the less-than-investment-grade borrower market. And spreading investment risk to these new players (besides originating loans, many hedge funds also trade leveraged loans in the secondary market) reduces the likelihood of a banking syste meltdown if this class of borrowers suddenly tanks.

But there are dangers aplenty, as well. First, hedge funds and their secretive brethren are so lightly regulated that neither governments nor markets have a complete sense of the lending exposure (or imprudent risks) taken by any market player. Next, heightened demand in the secondary market for the derivatives of these loans may encourage lax credit standards. And Britain's Financial Services Authority-the equivalent of the U.S. Securities & Exchange Commission—is examining whether some hedge funds are obtaining private information when making or buying loans in a company, then illegally using that insider intelligence tr trade the company's public securities.

It's too soon to say if this explosion of hedge fund lending is a blessing or a curse. But the growing financial reach of these players certainly convinces us that more government oversight is needed right now—before some hot money partnership inadvertently roils world markets.